TRUTH IN NEGOTIATIONS: A CONTROVERSIAL ISSUE

by

John Joseph McKechnie

TRUTH IN NEGOTIATIONS: A CONTROVERSIAL ISSUE

BY

John Joseph McKechnie
Bachelor of Science
University of Maryland, 1960

A Thesis Submitted to the School of Government and Business Administration of The George Washington University in Partial Fulfillment of the Requirements for the Degree of Master of Business Administration

September, 1969

Thesis directed by

Daniel David Roman, Ph.D.

Professor of Management

TABLE OF CONTENTS

CHAPTER I

INTRODUCTION

It is intended that Chapter I will explain the rationale for this thesis on the subject of the Truth in Negotiations Act. This chapter will also present the thesis organization, methodology, scope and limits, and a brief introduction to the purpose of Government procurement. The research question and subsidiary questions, whose answers it will be the goal of this paper to uncover, will also be stated.

The primary objective of Government contracting is to obtain the necessary supplies and services at a fair and reasonable price, calculated to result in the lowest overall cost to the Government.[1] This objective can be reached by either of two procurement methods: (1) formally advertised, or (2) negotiated. Congress, the sole appropriator of Government monies, has expressed a distinct preference for the formal advertising method. This method is believed to be superior because it generally provides a more competitive basis for the awarding of a contract and, therefore, affords

---

[1]U.S., Department of Defense, Armed Services Procurement Regulations, The 1969 Edition (Washington, D.C.: Government Printing Office, 1968), par. 3-801.1. Cited hereafter as ASPR.

the greatest protection to Government funds. Congress, recognizing that all procurements cannot be accomplished by formally advertising for bids from qualified sources has permitted an alternative, the use of the negotiated method of procurement.

Purpose of Thesis

It is the purpose of this thesis to analyze one legislative act that was designed to ensure that the Government employee who negotiates contracts for the procurement of goods or services for the Government has accurate, complete, and current cost or pricing data available. This is to ensure a knowledge level on a par with the contractor and to result in an effective contract negotiation. It is the belief of the Congress that the Government's negotiator must rely on contractor supplied cost or pricing data, and that it must be reliable in order to protect the taxpayers' money. As a means of ensuring the reliability of the cost or pricing data the contractor is required to certify that his data are accurate, complete, and current. This certification is required by Public Law 87-653 when there is an absence of adequate price competition or an established catalog or market price of commercial items sold in substantial quantities to the general public.

In its simplest terms, with which there is no dispute, the purpose of PL 87-653 is to ensure that truthful data are available to both parties in the negotiation of

contracts for goods and services. This basic idea has caused a considerable amount of consternation in and out of Government. The forword to a recent book on the Law describes the situation as ". . . unlike many congressional enactments which cause a brief flurry of activity followed by a subsidence into administrative routine, the Truth in Negotiations Act has led over time to more and still more confusion, misunderstanding and dislocation."[1]

The Participants

The passage of PL 87-653 heralded the beginning of a many-sided conflict regarding the necessity for, and implementation of, this law to ensure truth in the negotiation of Government contracts. The date of the passage into law of PL 87-653 was the culmination of seven years of Government Accounting Office (GAO) investigative effort which included numerous reports to Congress as well as hours of Congressional testimony by GAO, the Department of Defense (DOD), and industry. The principal adversaries in this continuing conflict for the effective implementation and enforcement are GAO, in the role of watchdog for Congress and protector of the taxpayers' monies; DOD, as the most prolific contract writer and expender of Government funds; and industry, the recipient of the contracts, the funds, and the profit.

---

[1]Machinery and Allied Products Institute, The Truth in Negotiations Act...a MAPI Symposium (Washington, D.C.: Machinery and Allied Products Institute and Council for Technological Advancement, 1969), p. iv.

Implementation

Since the inception of PL 87-653 there has been difficulty on the part of the Government in obtaining strict compliance with the Law. The difficulties have occurred in Government as well as industry. Numerous reasons for the difficulties have been given, two of which are differences in interpretation of the intent of the Law, and inadequate records of negotiation with resultant auditor charges at a later date of failure to disclose pertinent information.

Critical reports, by GAO, of noncompliance with the law have produced numerous Congressional hearings. These hearings combined with Armed Services Board of Contract Appeals (ASBCA) decisions have been responsible for stricter interpretation and enforcement of the Law, clarification of some questions about the Law and the surfacing of new questions.

In an effort to comply with PL 87-653, both Government and industry have instituted training programs and symposiums to indoctrinate their employees and to examine the purpose and effect of the Law's requirements. Preaward surveys of contractor submitted cost or pricing data have been augmented by postaward audits to determine if there is compliance with the Law.

Scope and Limitations

The motivating question and primary purpose of this thesis is to discern the reason "Why Public Law 87-653 is so difficult to satisfy." This question applies equally to Government and industry and will be viewed from each perspective. In order to arrive at a conclusion it will be necessary to delve into the factors that motivated Congress to pass the legislation and to determine from the legislative history what Congress intended the Law to accomplish. It will also be necessary to determine if the Law has been fully implemented by Government and accepted by industry. A final area of inquiry that could assist in arriving at a conclusion is the effect of ASBCA decisions in clarifying the requirements of PL 87-653.

It is not the purpose of this thesis to delve into the legalistic basis or interpretation of PL 87-653; rather, the Act will be viewed from the layman's position with respect to its implementation and effects. The question of the Law's effect upon subcontractors will be avoided since, in general, the same problems exist in prime contracts except for the added complication of appeal rights.

The period to be covered by this writing will be from 1955, when GAO commenced defense contract audits, to 1969.

Methodology

The research question and its subsidiary questions will be discussed and analyzed from information obtained from:

1. Congressional hearings and reports.
2. GAO Reports to Congress.
3. Government training manuals and circulars.
4. Industry memorandums, symposiums and publications.
5. Personal interviews with Government and industry employees that are involved in various aspects of the utilization, enforcement, of the Truth in Negotiations Act.

Inductive reasoning will be used to arrive at a conclusion as to why the Law is so difficult to satisfy.

Organization

The contents of this thesis will be arranged in the following sequence:

Chapter II presents the purpose and origin of PL 87-653, the legislative history of the bill, and any subsequent revisions to the law.

Chapter III discusses the steps taken to implement PL 87-653 and the problems encountered by Government and industry in the implementation of and conformance to the Law. The Armed Services Board of Contract Appeals, its decisions, and their effect on implementation will be discussed.

Chapter IV reviews the authority, evolution, and effect of preaward and postaward auditing of cost or pricing data submitted to Government negotiators. The auditing role of

GAO and the Defense Contract Audit Agency (DCAA) are compared and contrasted.

Chapter V surveys the efforts of GAO to promote Government agency enforcement and Congressional strengthening of the Law.

Chapter VI will summarize the conclusions reached in the foregoing chapters and answer the subsidiary questions as well as the research question.

CHAPTER II

THE LAW

Introduction

Chapter II will present the background for the discussion of Public Law 87-653, commonly called the Truth in Negotiations Act (H.R. 5532). The various procurement methods permitted by Armed Services Procurement Regulations (ASPR) will be reviewed, with particular attention paid to the Negotiated method.

The purpose and origin of PL 87-653 and the motivation of the prime movers of the Law--GAO and the Honorable Carl Vinson--will be discussed. The long legislative process of hearings and the succession of proposals to amend the Armed Services Procurement Act of 1947 will be followed. The final passage of the bill and its revisions will complete this chapter and set the stage for a discussion of the implementation of the Act.

Background

Government procurement

Congress is historically tied to the principle of competition in procurements as a means of ensuring that the Government receives the best price in the purchase of goods

and services. Of particular concern to Congress is that all bidders receive fair and equitable treatment at the hands of the Government contracting officers. The opportunity for all firms, large and small, to participate in contracts to provide goods and services to the Government is of equal concern.

Congress, drawing on 150 years of Government procurement experience, passed the Armed Services Procurement Act in 1947. This Act consolidated and revised the existing laws relating to military procurements and placed in one set of regulations, the Armed Services Procurement Regulations (ASPR), all of the authority and limitations for military procurement. The original purpose of the 1947 Procurement Act was to reestablish the primacy of the competitive Formal Advertising method of procurement in the placement of Government contracts for goods and services.[1]

Methods of procurement

Government procurement utilizes two principal procedures for awarding contracts. The method favored by Congress is Formal Advertising, which awards either Firm Fixed-Price Contracts or Fixed-Price Contracts with Escalation Clauses. A variation of Formal Advertising, the Two

---

[1]U.S., Congress, House, Amendments to the Armed Services Procurement Act of 1947, Chapter 137, Title 10, United States Code, Rept. 1638 to Accompany H.R. 5532, 87th Cong., 2d Sess.,1962, pp. 1-2.

Step Method, is designed to obtain the benefits of Formal Advertising when inadequate specifications are present.

The secondary procurement method is termed Negotiated. This method is permitted only when the Formal Advertising method is not feasible and when an exception to the requirement to Formally Advertise has been granted by proper authority.[1] The Negotiated procurement method permits the award of two categories of contracts:

1. Fixed-Price contracts, which consist of the following types:

   a. Firm Fixed-Price contract.
   b. Fixed-Price Contract with Escalation.
   c. Fixed-Price Incentive Contract.
   d. Prospective Price Redetermination.
   e. Retroactive Price Redetermination.[2]

2. Cost-Reimbursement Type Contracts, which include:

   a. Cost.
   b. Cost-Sharing.
   c. Cost-Plus-Incentive-Fee (CPIF).
   d. Cost-Plus-Award-Fee (CPAF).
   e. Cost-Plus-a-Fixed-Fee (CPFF).[3]

Formal Advertising method.--Congress desires that the majority of the Government procurements, regardless of size and complexity, be contracted for by means of the Formal Advertising method. This method requires that the procurement be advertised and that prospective contractors respond with sealed bids.

---

[1] ASPR, par. 3-101.

[2] Ibid., par. 3-404.

[3] Ibid., par. 3-405.

The Formal Advertising method of procuring goods and services applies to Government procurements if the following criteria are present:

1. A complete, accurate and realistic specification or purchase description must be available.

2. There must be two or more suppliers available, willing and able to compete effectively for the contract.

3. There must be sufficient time to carry out the various administrative tasks, i.e., preparation of the Invitation for Bids (IFB), contractor bid preparation, publicity period, bid evaluation and, in many instances, evaluation of bidder responsibility.

4. The selection of the successful bidder can be made on the basis of price and other factors, provided the lowest responsible bidder's response meets the requirements of the IFB without exception or new conditions.

Negotiated Procurement method.--If the Formal Advertising criteria are not present in the prospective procurement the alternate method of obtaining the required goods or services is then relied upon; namely, negotiated procurement.

Negotiated procurements, because of the possibility of restricting competition, are limited to those situations where all of the following circumstances exist:

A. The use of Negotiation must be authorized by one of the following seventeen exceptions:
   1. National Emergency.
   2. Public Exigency.
   3. Purchases not in excess of $2,500.

4. Personal or Professional Services.
5. Services of Educational Institutions.
6. Purchases outside the United States.
7. Medicines or Medical supplies.
8. Property procured for resale.
9. Subsistence Supplies.
10. Absence of competition.
11. Experimental, Developmental or Research Work.
12. Classified Purchase.
13. Standardized or Interchangeable Technical Equipment.
14. Technical or Specialized Supplies.
15. Negotiation after Advertising.
16. Purchases for National Defense or Industrial Mobilization.
17. Otherwise authorized by law.[1]

B. necessary determination and findings have been made by government personnel;
C. internal agency clearance has been obtained; and
D. the prospective contractors have been determined to be responsible.[2]

In the Negotiated method of procurement the Request for Proposal (RFP) is solicited from the largest number of qualified sources, consistent with the nature of the requirement, in order to secure the best "price and other factors" advantage for the Government.

It is within the framework of the Negotiated method of procurement that the Truth in Negotiations Act has evolved. Initially, incentive type contracts were the object of legislative interest but this gave way to include all Negotiated type contracts.

Unlimited negotiation authority

At the outset of the Korean Conflict, President Truman issued the Korean National Emergency Proclamation.

---

[1] Ibid., par. 3-200 - 3-217. [2] Ibid., p. 3-102.

The effect of this Proclamation on the ASPR was to invoke the "National Emergency" exception to the requirement to Formally Advertise. This expedient for the prosecution of the armed conflict in Korea was intended to speed the acquisition process. As would be expected, this unhindered power to negotiate contracts, instead of to formally advertise for them, was reflected by a dramatic increase in the dollar value of the Negotiated contracts awarded by DOD.

Congress expressed its fear that the Negotiation of contracts meant that the Government was not receiving the lowest possible price by enacting legislation. An amendment to the Armed Services Procurement Act was passed by Congress in 1951 which required that Government contracts contain a clause that would permit the Comptroller General to examine contractors' records.[1] This access-to-records amendment marked the beginning of the events that ultimately led to the passage of the Truth in Negotiations Act.

General Accounting Office intervention

With pressure from Congress and Comptroller General Joseph Campbell the audit efforts of GAO were redirected. Prior to 1955 GAO's prime concern was for developing techniques for the internal audit of governmental agencies. Its new interest became in the field of defense contracting.[2]

---

[1]U.S. Code 2313(b).

[2]U.S. v. Hewlett-Packard, Civil Action No. 41881, N.D. California, February 28, 1966.

An inordinate amount of Negotiated versus Formally Advertised contracts continued to be negotiated after cessation of Korean hostilities.[1] Congress, concerned about the loss of the competitive atmosphere, directed GAO to utilize the 1951 access-to-records authority and to delve into defense contractors' records in order to study the effect of little or no competition. By 1957, Congress was alarmed by the number of GAO reported cases of defective pricing data that had been submitted to Government negotiators. The results of these GAO audits were submitted to Congress in the form of Reports to Congress, which became known as "blue books." The blue-book reports gave publicity to the GAO discoveries and assisted in the recoupment of excess contractor profits by way of voluntary refunds. The reports also urged the procurement activities (DOD) to improve their negotiating techniques and to expand their auditing resources.

Excess profits

The recoupment of excess profit amounts that GAO audits found to be a result of defective pricing could be handled in one of three ways. GAO's preferred method was to encourage the procurement agency to seek a voluntary refund. The Renegotiation Board and the Department of Justice were the alternate methods and were available to handle aggravated cases of overpricing as well as criminal fraud cases.

---

[1]To date the Korean National Emergency Proclamation has not been revoked in total, although the moratorium on Formal Advertising was terminated in 1957.

The Renegotiation Board profit position is to take into consideration a company's profit picture for the entire year in order to determine if the Government is entitled to a refund. When a full year of profit is taken into consideration, a company can make a strong case for offsetting profits with losses and thereby average out a year's profits with the losses.

The excess profit theory that GAO operated under was that each contract was a separate agreement with the Government. Cost or pricing data were submitted on each negotiated contract, which determined the costs and the profit for that particular contract. Therefore, since risk is assumed on each contract in varying degrees, each contract must stand on its own outcome and not depend on other contracts to offset over- or under-pricing mistakes.

As far back as 1776 this principle of assumption of risk on an individual contract had been asserted. The Committee on Naval Affairs determined in the Kemp Shipbuilding Case (1776) that:

> When the petitioner entered into the contract, he necessarily took the chances of the rise or fall in the price of the articles necessary for its completion. If it (the price) had fallen, the advantage would have resulted to him, and not to the United States, and if it had risen, the loss should be his.[1]

---

[1]U.S., Congress, House, Committee on Armed Services, Review of Defense Procurement Policies, Procedures and Practices, Part I: Introduction and Truth-in-Negotiations (P.L. 87-653), Hearings before a subcommittee for Special Investigations, House of Representatives, 90th Cong., 1st sess., 1967, p. 1.

The voluntary contractor repayment of excess profits was not a wholly reliable method of recoupment of unearned profits for the Government. There was the possibility that contractors would average out the losses with the profits, contrary to GAO's position that each contract should stand alone. The contractors could also determine for themselves what percentage of their profits were excess. Neither of these alternatives was satisfactory. As a result, Congress and GAO were becoming increasingly uneasy about the mounting defense costs and about the reports of excessive profits.

The Legislative History of Public Law 87-653

The legislative history of the Truth in Negotiations Act spans the period from 1960 to 1962. The preliminary factors which led to the Act began in 1958 and changes have been initiated and enacted as recently as 1968. A chronology of the events surrounding the Act has been compiled to assist the reader in following the sequence.

Chronology of Truth in Negotiations

1947 - Armed Services Procurement Act passed by Congress.

1951 - Act amended granting GAO access to contractor records (10 U.S. Code 2313[b]).

1955 - GAO shift of audit emphasis from internal Government auditing to the area of defense contract audits.

1957 - Korean National Emergency Proclamation moratorium on Formal Advertising revoked.

1958 - U.S. Air Force instituted a requirement for contractor certification of cost data submitted in response to Request for Proposals.

1959 - ASPR revised to coincide with Air Force certification requirement.

1959 - Renegotiation Act extended three years. Congress directed House and Senate Armed Services Committees to study military procurement methods, policies and practices in conjunction with the extension of the Renegotiation Board.

1960 - H.R. 12299--Representative Vinson's first proposal to amend the Armed Services Procurement Act by restricting incentive contracting. Bill rewritten.

1960 - H.R. 12572--the revised H.R. 12299--required complete, accurate, and timely cost information. Passed House on June 24 and sent to the Senate Armed Services Committee. Tabled.

1960 - Senate Armed Services Committee Procurement Hearings made nine recommendations to DOD to improve contracting. No legislation offered.

1961 - H.R. 5532 (H.R. 12572 reissued)--Representative Hebert's reintroduction of the bill to control incentive contracting.

1962 - H.R. 5532--reported out of the House Armed Services Committee and passed by House in June 1962 by vote of 362 to 0. Sent to the Senate.

1962 - Senate received H.R. 5532, Truth in Negotiations Act. July 30 to August 6, H.R. 5532 Revised--Section "g" revised to section "e" and instead of controlling incentive contracting only, covered all classes of negotiated contracts. Required contractor data certification and contract price reduction for defective data.

1962 - August 23.--H.R. 5532 passed Senate, without debate.

1962 - August 28.--H.R. 5532 passed House of Representatives.

1962 - September 10.--H.R. 5532 became law and amended Armed Services Procurement Act of 1947, Chapter 137, Title 10, United States Code 2306(f). Public Law 87-653--Truth in Negotiations Act.

1962 - December 1.--Effective date of Truth in Negotiations Act. ASPR revised, and Act became effective.

1963 - August.--H.R. 7909--Representative Hebert proposed amendments to revise H.R. 5532 and to weaken it. Defeated.

1967 - November.--DOD administratively revised ASPR to permit postaward contract audits.

1968 - March.--H.R. 10573 and H.R. 13100 introduced by Representatives Minshall and Whalen respectively. Proposed to amend PL 87-653 to require postaward audit of contracts.

1968 - May 6.--H.R. 10573 passed House (H.R. 13100 withdrawn).

1968 - September 11.--H.R. 10573 passed Senate.

1968 - September 28.--Effective date of H.R. 10573 amendment to Truth in Negotiations Act.

By 1958 a sensitive Air Force had developed a procedure for the certification of contractor submitted cost data. This first step toward truth in negotiation of contracts was heralded by GAO. GAO, not completely satisfied, called on the Air Force to go a step further to strengthen its controls on contract pricing. This was to be accomplished by examining contractor records to ensure that the proposals were reasonable, and that the cost data were current, complete, and accurate.[1]

From 1958 to 1960, GAO probing and numerous blue-book reports to Congress on the insufficiency of cost data from contractors prompted a summary report on Air Force contracting.

---

[1]U.S., Congress, House, Committee on Armed Services, Weapons System Management, Hearings before a subcommittee for Special Investigations, House of Representatives, on H.R. 5532, 87th Cong., 1st sess., 1961, p. 361.

The report that was presented to Congress by Lawrence J. Powers, Director of Defense Accounting and Auditing Division of GAO, stated:

> The buyer's lack of knowledge and adequate consideration of the latest cost data available to the vendor in establishing prices is the most important weakness observed in the cases covered by this report.[1]

ASPR revised

The ASPR provided an administrative remedy to GAO demands for profit control when it was revised in October 1959. A cost or pricing data accuracy certification was required for cost or pricing data submitted by prime contractors when a negotiated procurement was expected to exceed $100,000, when (1) the proposed price was an estimate rather than the result of competition, or (2) there was not an established catalog or market price or price set by law. This ASPR requirement did not provide for any reduction in price if defective data were submitted.

Momentum was now building in Congress for the enactment of some legislation to govern contract negotiations. This momentum was the result of the GAO blue-book reports, Congressional hearings, and apparently unsuccessful administrative procedures for the control of excessive profit.

Renegotiation Board

At this same point in time another factor appeared which would ultimately influence the passage of a Truth in

---

[1] Ibid., p. 350.

Negotiations Act; namely, the deadline for the lapse or extension, no later than June 30, 1959, of the Renegotiation Act of 1951. The Renegotiation Act is based on the principle of flexible renegotiation of Government contract profits without formula or percentage to determine what is excessive.[1] After certain allowable costs, excess profits determination is based on capital employed, character of business, defense effort contribution, assumed risk, efficiency of operation, and reasonableness of costs and profit.[2] This determination by the Renegotiation Board encompasses the profits received from Government contracts and subcontracts for the fiscal year and permits the carryover of a loss for five years.

The House Ways and Means Committee presented the House with a bill to extend the Renegotiation Act for four years. There was an amendment in the bill to give special consideration to the risk-incentive situation that is present in incentive contracts which involve not only the opportunity for higher profits as do Cost-Plus contracts, but also the possibility of lower profits or even a loss.[3]

---

[1]Commerce Clearing House, Inc., 1968 Government Contracts Guide (Chicago: Commerce Clearing House, Inc., 1968), par. 502.

[2]ASPR, par. 1-319.

[3]U.S., Congress, House, Representative Wilber D. Mills speaking for the Renegotiation Act extension, H.R. 7086, 86th Cong., 2d sess., May 26, 1959, Congressional Record, CV, 9137.

Renewal of the Renegotiation Act did not seem in jeopardy until this effort was made to exclude incentive-type contracts from the purview of the Renegotiation Board. It was the position of industry in this matter that incentive contracting, a legal form of Government contracting, was intended to reduce costs and reward the efficient contractor by increasing his profits. Industry also felt that increased efficiency and thereby profits were in danger of being drained off through renegotiation.

Congressman Carl Vinson, long an opponent of incentive contracting, which he felt provided an opportunity for excess profit, and author of various profit control bills over the years, stepped into the contest.[1] The House passed the extension bill in spite of Mr. Vinson's objection to the special consideration given to incentive contracts. The bill was sent to the Senate where Mr. Vinson personally appeared as a witness before the Senate Finance Committee in an attempt to eliminate any special consideration for incentive contracts. A Senate bill was substituted for the House bill and extended the Renegotiation Act for three years. The Senate bill also called for the Joint Committees on Internal Revenue Taxation to study the subject of renegotiation. The House and Senate Armed Services Committees were instructed to report the findings of their investigation

---

[1] Vinson - Trammel Act, 1934; Smith - Vinson Act, 1942; and H.R. 9246, H.R. 9564 during the 81st Cong., 2d sess., which led to the Renegotiation Act of 1951.

to their respective Houses by September 30, 1960.

In order to study fully the renegotiation subject the Committees were directed to study military procurement methods, policies, and practices and to consider the effectiveness of contractual instruments in achieving reasonable costs, prices, and profits in defense procurement.[1] The study was stated not to be an indictment of all defense contractors or Government contracting officers.

It appeared in the early stages of the investigation that there was an inequity in negotiations, that Government was not on the same knowledge level as industry where the matter of current costs and pricing data was concerned. GAO blue-book reports indicated that the primary cause of the inequity and the resultant overpricing of contracts was the contractor's failure to provide accurate, current or complete cost data. It was contended by GAO that the Government's negotiator would be in a better position to establish an equitable price if contractor cost data were made available.[2]

Legislative Hearings

House action

In the House of Representatives a Special Subcommittee on Procurement Practices, chaired by Mr. Vinson, set

---

[1]House, Amendments to the Armed Services Procurement Act of 1947, Rept. 1638, p. 3.

[2]Herbert Roback, "Truth in Negotiating: The Legislative Background of P.L. 87-653," Speech presented to the American Bar Association, Honolulu, Hawaii, August 8, 1967, Public Contract Law Journal, I, No. 2 (July, 1968), 10.

about to perform the required procurement study. Mr. Vinson focused on incentive contracting as the culprit for encouraging excess profits. It was his contention that if a contractor overestimates his costs, then his cost estimate, as an element in determining target cost and ultimately target profit, is increased. The thrust of Chairman Vinson and former Comptroller General Campell's proposals to the Committee were to limit incentive profit to those cases where the contractor could prove that his efforts resulted in savings to the Government. This would reward efficient contractors and eliminate windfall profits. In order to accomplish this type of control on incentive contracting it would be essential that the contractor supply reasonable proposals and strong justification to support his proposals. For a Government negotiator to justify the contractors' proposals would require access to the contractors' working papers or an audit of pertinent records. This was not a new theme, but Mr. Vinson was determined to make an issue of the incentive contracting profit loophole and carry the issue to the statutory stage.[1]

Proposed legislation.--In May of 1960, Mr. Vinson requested J. Edward Welch from the GAO Office of General Counsel and the subcommittee Special Counsel, John J.

---

[1]U.S., Congress, House, Committee on Armed Services, Hearings Pursuant to Section 4, Public Law 86-89, before a Special Subcommittee on Procurement Practices of Department of Defense, House of Representatives, Appendix 4: Considerations of H.R. 12299, 86th Cong., 2d sess., 1960, pp. 125-41.

Courtney, to draft legislation that would control incentive contracting. These gentlemen and the House Special Subcommittee produced H.R. 12299, which proposed several amendments to the ASPR. One of the amendments in particular was aimed at incentive contracting and stated that contracts would carry a clause that would require that the contractor prove he was responsible for any reduction in costs which would increase his profit.[1]

The DOD presented arguments against the proposed amendment saying that it was impractical and that the administration of the proposal would be burdensome. The most telling arguments presented by DOD Counsel James P. Nash were that the legislation would require DOD to retreat to Cost-Plus contracting and that the language of H.R. 12299 might be construed as prohibiting Firm-Fixed-Price contracts.[2] It was further argued that the ASPR revisions implemented in 1959 were sufficient since they were initiated by GAO. The ASPR regulations then in effect did not permit the award of a negotiated contract without prior written or oral discussion unless (1) all offerers were warned to quote their best price initially, (2) very substantial competition existed, or (3) extensive prior audited cost experience was present.[3] The ASPR also

---

[1] Ibid., pp. 623-24.

[2] Ibid., pp. 656-57.

[3] ASPR, par. 3-805(b) (1958).

required contractors of contracts over $100,000 to certify that all available cost or pricing data were considered in preparing the price estimate and that the data were made known to the contracting officer.

Congressman William H. Bates expressed the opinion of a number of the opponents to H.R. 12299 when he remarked that the subcommittee was attempting to legislate judgment, a factor that cannot be legislated.[1] With the skepticism of subcommittee members evident, Mr. Vinson ordered a revision of the amendment.

First revision.--GAO rewrote the original bill with assistance from DOD; the result was presented to Mr. Vinson as H.R. 12572. While still concentrating on incentive contracting, the new bill carried for the first time the language--the requirement--for complete, accurate, and timely cost information. Also introduced for the first time was the price reduction requirement to be utilized if, upon audit, defective data were found to have been submitted by the contractor.

H.R. 12572 met with success and was passed by the House of Representatives on June 24, 1960, to the personal pleasure of Mr. Vinson. Representative Bates, in endorsing the bill on the floor of the House, will probably be remembered for his expression of confidence that the

---

[1]House, Hearings, Considerations of H.R. 12299, p. 723.

enactment of H.R. 12572 would eliminate most of the kinds of overpricing that GAO audits uncovered.[1]

Senate action

The Senate Armed Services Subcommittee was in the midst of its own defense procurement hearing when H.R. 12572 was sent from the House--it was pigeonholed. The Armed Services Procurement Subcommittee, chaired by Senator Strom Thurmond, had heard much the same testimony as their counterparts in the House. There was a difference in the reception the testimony received, especially that of DOD, who advised the subcommittee of the ASPR regulation presently in effect to preclude such occurrences as H.R. 12572 was designed to eliminate. The GAO testified that they were not yet able to evaluate the effectiveness of the DOD referenced ASPR regulations, which they themselves had sponsored.[2]

Chairman Thurmond directed DOD and GAO to develop a more suitable procurement law amendment which followed the cost certification aspect of H.R. 12572, but he also desired that incentive profits which were unrelated to the contractor's efforts be prohibited. The GAO responded by

---

[1]U.S., Congress, House, Representative Bates speaking for Amendments to Armed Services Procurement Act of 1947, H.R. 12572, 86th Cong., 2d sess., June 24, 1960, Congressional Record, CVI, 14258.

[2]U.S., Congress, Senate, Committee on Armed Services, Amendments to Armed Services Procurement Act of 1947, Hearings before Procurement Subcommittee, 86th Cong., 2d sess., 1960, pp. 151-52.

reviving part of the House rejected H.R. 12299, which required contractors to prove that their efforts resulted in lower contract costs and thereby entitled them to the incentive profits. Contractor cost certification was also a requirement of the revised bill, thereby imposing two kinds of statutory obligations on contractors and placing the burden of proof on them and not on the Government.

In the later stages of the legislative session the calmer Senate procurement subcommittee credited DOD with a sincere effort to improve its procurement methods. They also desired to allow GAO time to evaluate the 1959 DOD administrative changes to ASPR. This attitude was in keeping with the subcommittee report, one week prior to adjournment, that it was their conclusion that the procurement problems of DOD could be solved by administrative procedures.[1]

Administrative versus statutory changes.--The Senate Armed Services Committee "Report on Procurement" to the Senate on August 23, 1960, made nine recommendations to DOD for the administrative improvement of procurement practices. One recommendation is worthy of note in that it recommended a contractual provision to permit the adjustment of the target cost to exclude any amount by which the target cost was increased due to contractor submitted inaccurate, incomplete, or noncurrent cost data. This

---

[1]U.S., Congress, Senate, Armed Services Committee, Report on Procurement, S. Rept. 1900, 86th Cong., 2d sess., 1960, pp. 26, 28.

recommendation for a price adjustment to incentive contract provisions was thought to be the answer to Representative Vinson's legislative proposal as well as a method of closing the loophole in existing regulations. The DOD took this Senate recommendation one step further and instead of adding a price reduction clause to incentive contracts only, added it to all types of negotiated contracts.

Final submission

Commencing with the Eighty-seventh Congress in 1961, Representative F. Edward Hebert became Chairman of the House Subcommittee for Special Investigations, relieving Mr. Vinson. As the first order of business Mr. Hebert reintroduced the Vinson bill, H.R. 12572, as H.R. 5532, which was quickly passed by the House Special Investigations subcommittee without waiting either for formal comments that had been solicited from GAO and DOD or for witnesses. The House Armed Services Committee did not act on H.R. 5532 because of Mr. Vinson's belief that the bill would not pass the Senate.

H.R. 5532 comments.--In April of 1961, the DOD General Counsel, Cyrus R. Vance, submitted comments opposing H.R. 5532.[1] The thrust of the DOD objections were that a law would be inflexible, whereas regulations could more easily keep up with changing procurement situations. H.R. 5532 singled out incentive contracting for special treatment while

[1]House, Amendments to the Armed Services Procurement Act of 1947, Rept. 1638, pp. 7-12.

the DOD regulations were not thus limited. The final objection was that the ASPR went beyond H.R. 5532 and required profit reductions for defective pricing as recommended by the Senate at the end of the previous legislative session.

GAO's comments were the same as those presented to the subcommittee chaired by Senator Thurmond the previous year. The ASPR was recognized as having several of H.R. 5532's provisions but GAO stressed that administrative regulations, which are changeable, were not a substitute for law.

The House Armed Services Committee finally reported out H.R. 5532 in April 1962, a year after it was first introduced. In the report accompanying H.R. 5532 DOD acquiescence and GAO support for the bill were stated, although DOD had commented earlier that "the Department is opposed to enacting this provision into law."[1]

The House Armed Services Committee opposition to H.R. 5532 was strong enough to result in the issuance of a minority report. The Committee's unprecedented minority report was issued supporting the DOD approach of administratively controlling procurement through the Secretary of Defense and the ASPR instead of by statute.[2]

---

[1]House, Amendments to the Armed Services Procurement Act of 1947, Rept. 1638, p. 10.

[2]U.S., Congress, House, Armed Services Committee, Amendments to the Armed Services Procurement Act of 1947, Rept. 1638, Pt. 2 (Minority Report) to Accompany H.R. 5532, 87th Cong., 2d sess., 1962, p. 4.

The House passes H.R. 5532.--The House bill H.R. 5532 passed the House on June 7, 1962, by a vote of 362 to 0, but not without a memorable statement by Representative H. Allen Smith. Representative Smith was speaking about the section of the bill pertaining to downward price adjustments when defective pricing was discovered but that increases were not permitted:

> It has the effect of requiring that a contractor's foresight must be as precisely accurate as an auditor's hindsight, a state of perfection not attainable this side of transmigation to a higher state of heavenly existence.[1]

It was Mr. Smith's view that fair dealing should permit profit increases as well as decreases.

In defense of the bill, Mr. Hebert, the sponsor, revealed new GAO figures that showed that the ASPR requirement for obtaining certificates of cost or pricing data for negotiation were not obtained by the Army or Navy in 121 of 276 cases reviewed between January 1960 and June 1962.[2] The Air Force had learned its lessons well because in 88 cases that GAO reviewed there was 100 percent ASPR conformance.[3]

---

[1]U.S., Congress, House, Representative H. Allen Smith, speaking against the Amendment to the Armed Services Procurement Act of 1947, H.R. 5532, 87th Cong., 2d sess., June 7, 1962, Congressional Record, CVIII, 9968.

[2]U.S., General Accounting Office, Review of Extent to Which Military Procurement Agencies and Prime Contractors Have Obtained Certifications as to the Accuracy and Completeness of Cost Data Used in Negotiation of Contract Prices, Report to Congress, B-125050, October 4, 1960 (Washington, D.C.: Government Printing Office, 1960).

[3]Ibid.

To Mr. Vinson's thinking this GAO report reinforced his contention that incentive contracting rewarded deceptive negotiating or superior guesses rather than demonstratable superior performance. It also proved that legislation was required and that administrative regulations were ineffective because the Armed Services were not adhering to their own ASPR regulations.

The Senate and H.R. 5532.--Mr. Vinson followed H.R. 5532 to the Senate to preach its merits and to do all in his power to ensure the enactment of the amendment. The section of H.R. 5532 that was of special interest to Mr. Vinson was the section that dealt with full disclosure in negotiations and target price readjustment in incentive contracts. In order to see this section through into law Mr. Vinson was willing to sacrifice the rest of the bill. He felt that "if it is a good regulation, it will be a good law."[1]

Committee testimony.--DOD continued its opposition to H.R. 5532 principally because it was felt that the bill would eliminate incentive type contracting as a procurement tool. Assistant Secretary of Defense (Installations and Logistics) Thomas D. Morris argued that the ASPR regulations were now being enforced and that the ASPR went beyond the proposals contained in H.R. 5532. He further advocated the

---

[1]U.S., Congress, Senate, Committee on Armed Services, Amendments to the Armed Services Procurement Act of 1947, Hearings on H.R. 5532, 87th Cong., 2d Sess., 1962, p. 15.

enactment of the ASPR regulations if the committee continued to feel that a statute was necessary.[1]

GAO was placed in the enviable position of being able to draw support from both DOD and Mr. Vinson. GAO blue-book reports asserted that the failure of the Army and Navy to obtain contractor certifications may have resulted in higher contract costs and probably weakened Government profit recovery chances. For this reason GAO and Congress felt that a statute was needed. Since some statute was to be enacted GAO sided with DOD in its reasoning that the legislation should cover all negotiated contracts and not single out incentive contracts.

Mr. Vinson, in his testimony before the Senate Armed Services Committee, was reluctant to abandon his position that incentive contracts were the culprit that cost the Government additional millions of dollars. He was of the belief that H.R. 5532 would close the incentive contracting loopholes and that broader coverage was not needed. Mr. Vinson felt that DOD and GAO were going too far with their recommendations for broader coverage.[2]

Chairman Russell, of the Senate Armed Services Committee, finally convinced Mr. Vinson that the price for the enactment of legislation to control incentive contracting would be the broader Senate coverage of all contracting or nothing. Mr. Russell commented: "I am not going to support

---

[1] Ibid., pp. 42-44. [2] Ibid., p. 22.

any legislation that just applies to these incentive contracts and drive everybody out of the incentive field to cost plus where we will really get rooked."[1] The Senate desire for legislation was a direct result of the GAO blue-book reports of DOD noncompliance with the existing ASPR regulations.

Comparison of the two H.R. 5532's.--During the period July 30 to August 6, 1962, representatives of DOD and GAO drafted a revised H.R. 5532 for the Senate Armed Services Committee. Section "g" of the House version of the bill was revised to become section "e" of the new Senate version. The House bill (section "g") applied to incentive contracts only and required:

1. That contractor certified cost and pricing data be accurate, complete, and current.
2. That the data be submitted in negotiation.
3. That an audit will be made prior to the application of the profit-sharing formula to determine whether the costs used in negotiation were accurate, complete, and current.
4. That if the figures were not accurate, complete, and current, the target price be reduced to the extent that the figures were not accurate.
5. That only after the audit and reduction of the target price, if required, would the profit formula be applied.[2]

The revised Senate version of the bill (see Appendix A) drew upon existing ASPR regulations and the testimony

---

[1] Ibid., p. 65.

[2] U.S., Congress, House, Representative Vinson, speaking on the Amendment to the Armed Services Procurement Act of 1947, H.R. 5532, 86th Cong., 2d sess., June 24, 1960, Congressional Record, CVI, 14257.

of GAO and DOD. In its final form the Amendment to the Armed Services Procurement Act of 1947:

1. Applied to all negotiated contracts.
2. Required contractor certificates of accurate, complete, and current cost or pricing data on all contracts or subcontracts over $100,000.
3. Permitted price adjustment if the price was increased by defective cost or pricing data.
4. Permitted exceptions to the certification requitement.
5. Did not include the audit requirement, proposed by the House, prior to profit formula determination.[1]

The Congressional attitude.--The views of the Senators and Representatives toward H.R. 5532, as a method of bringing truth to the negotiation table were, in general, simplistic. Mr. Hebert stated:

> Truth works wonders. All this section [sec."g"] requires is that the truth be made known at the time of bargaining. Who can object to telling the truth? The argument about persons being penalized for what they do not know is plain nonsense. The truth is nothing more or less than what a contractor knows when he opens his mouth. What he does not know, he does not speak.[2]

It was Mr. Vinson's view that if all facts known to the contractor were disclosed at negotiation and nothing was hidden there would be no problem and the contractor would receive his incentive profit.[3] Senator Symington perceived the issue to be "efficiency and intelligence" instead of

---

[1]U.S., Congress, House, Passage of Amendment to Armed Services Procurement Act of 1947, H.R. 5532, Truth in Negotiations Act, 87th Cong., 2d sess., August 28, 1962, Congressional Record, CVIII, 17920.

[2]Senate, Hearings on H.R. 5532, Amendments to the Armed Services Procurement Act of 1947, p. 57.

[3]Ibid., p. 25.

"integrity" and observed that a contractor who erred whether it be by design or by neglect would not be rewarded.[1] The principal point here is that if a contractor makes an honest error in calculating his cost or pricing data and he thereby inflates his costs, he does not lose anything by a price reduction, but merely gives back to the Government its due.

The GAO attitude.--GAO concurred in the interpretation and purpose of the bill that Senator Symington had set forth. GAO had long advocated that legislation and not administrative regulation was required because regulations change too rapidly and are not easily enforced. In the matter of price reductions, GAO policy concerning each contract standing on its own merits acted as a safeguard against a contractor "buying in" with low bids in order to obtain follow-on contracts with which to profit. This principle also prevented the Government from assuming risk that the contractor was being paid to accept.

With the right of price reduction a new question arose concerning the balancing out of individual items of cost or pricing data. The right to "offset" underpricing with overpricing was held by GAO to be not allowed. The argument advanced by GAO was that the contractor was in a position of superior knowledge; it was data that he had prepared and certified and that the Government was not in

---

[1] Ibid., p. 26.

a position to insure him against his own mistakes. The final argument presented was that for every error the Government found the contractor could find many more because the contractor had more time and personnel with a more intimate knowledge of the contract.

The industry attitude.--Industry was not particularly favorable toward the amendments proposed by either of the H.R. 5532's. The principal question that industry had was that the term "data" was not defined and that they could not distinguish between actual and estimated costs. There was also a fear that innocent mistakes would be penalized and that offsets would not be permitted.

In general, the industry position was that the proposed amendment would discourage incentive contracting, would subject innocent offenders to possible criminal prosecution, would demand a "perfection of data impossible to achieve," was completely one-sided and unfair, would subject the contractors to risks of indefinite duration for downward price revisions, and, similarly, would put a lingering statutory cloud on their accounting statements.[1]

Senate passes H.R. 5532.--On August 23, 1962, without debate, H.R. 5532 passed the Senate.[2] Five days later, on August 28, the House passed the bill which became law on

---

[1] Ibid., pp. 95,1103.

[2] U.S. Congress, Senate, Passage of Amendment to Armed Services Procurement Act of 1947, H.R. 5532, Truth in Negotiations Act, 87th Cong., 2d sess., August 23, 1962, Congressional Record, CVIII, 17351.

September 10, 1962.[1] Between the passing of the law and its effective date, December 1, 1962, DOD revised the ASPR to reflect the requirements of this Truth in Negotiations Act. Since 1962 all other Government agencies have become subject to the Law.

Revisions to the Act

First attempt

After the Truth in Negotiations Act had been law for eight months, Representative Hebert, the author of H.R. 5532, introduced H.R. 7909 with four proposed changes to the Act. Mr. Hebert's amendments would (1) ensure that pricing data certificates would not be required on contracts less than $100,000, (2) permit offsets of over- and underpricing due to inaccurate, incomplete or noncurrent cost data in order to balance out price adjustments but not to increase the total price, (3) authorize contract price adjustment only if the contractor had knowledge of the deceptive data that were certified, and (4) prohibit, rather than leave discretionary, the use of certificates when the negotiated price is based on competition, established catalog or market price.[2]

---

[1]House, Passage of Amendment, Congressional Record, CVIII, 17920.

[2]Roback, "Truth in Negotiating."

Rebuttal

Both GAO and DOD were opposed to all of Mr. Hebert's proposals.[1] Specifically, the arguments against H.R. 7909 were:

1. $100,000 floor.--Proposed $100,000 floor on certification requests stressed that:

   a. Nothing in legislative history showed Congressional intent to prevent administrative requirements on lesser amounts.
   b. A statutory prohibition would seriously affect the negotiation of reasonable prices.
   c. Overpricing of many small contracts is just as costly as overpricing a few contracts over $100,000.

2. Offsets.--This amendment was dismissed as not being in the best interest of the Government because:

   a. It would place the Government in the role of insurer of the contractor who submitted the low bid, especially if the contractor knew it was low.
   b. It would encourage buying-in.
   c. It would not penalize the contractor if the certified cost or pricing data are inaccurate, incomplete or noncurrent since the Government recovers only the overcharge.

3. Honest mistake.--The proposal to recognize the honest mistake as against the dishonest mistake can be argued with the same responses used against offsets. Additionally, it can be pointed out that the price adjustment (downward) is not punitive and the findings are not of contractor guilt, but, rather, of fault in the data submitted. The mistakes are corrected by the price adjustment whether the contractor is innocent of "knowledge" or not.

---

[1] Ibid.

A dishonest mistake can be handled by criminal and civil fraud statutes. The purpose of the Truth in Negotiations Act was to control defective pricing data where the contractor had the responsibility for submitting correct data.[1] If the Government had to prove whether a mistake was "honest" or "dishonest," the requirement would effectively nullify the law.

4. Mandatory certificate exemption.--GAO and DOD desired to retain the administrative flexibility of the existing law. It was felt that in special situations even though the price was based on competition or established catalog or market price there might be a need to request cost or pricing data certifications to protect the Government.

Mr. Hebert's proposed amendment to the Armed Services Procurement Act was defeated.

The Law is amended

DOD, in November of 1967, issued Defense Procurement Circular (DPC) number 57 to administratively revise certain sections of the ASPR. One of the revisions was the insertion, in noncompetetive fixed-price and cost type contracts, of a clause to permit the postaward audit of

---

[1]Elmer B. Staats, Comptroller General of the United States, "The Truth in Negotiations Act in Perspective," The Truth in Negotiations Act . . . A MAPI Symposium (Washington, D.C.: Machinery and Allied Products Institute and Council for Technological Advancement, 1969), p. 8.

contractor data upon which reliance was placed for the proposal submission.[1]

In March 1968, the House Special Investigations Subcommittee opened hearings on two identical bills--H.R. 10573 and H.R. 13100--introduced by Representatives Minshall and Whalen respectively, on the subject of postaward audits.[2] It was Mr. Minshall's intention to save "billions of defense dollars" by the enactment of his bill "that would guarantee a full-fledged post audit, by the Department of Defense, of all financial records of defense contractors and subcontractors to determine whether the Government is being overcharged."[3] Mr. Minshall remarked that DOD had issued auditing procedures[4] "much in line with the intent" of his bill but that his long experience in dealing with the military had warned him that such regulations are "subject to change, misinterpretation or oversight."[5] Both GAO and DOD acknowledged the need for postaward audits although DOD

---

[1]U.S., Department of Defense, Defense Procurement Circular Number 57 (Washington, D.C.: Government Printing Office, 1967), pp. 4, 6.

[2]U.S., Congress, House, Armed Services Committee, Truth in Negotiations (H.R. 10573), Hearings before a Subcommittee for Special Investigations, House of Representatives, 90th Cong., 2d sess., 1968), p. 7567.

[3]Ibid., p. 7569.

[4]Defense Procurement Circular No. 57.

[5]House, Hearings on H.R. 10573, Truth in Negotiations, p. 7569.

would have been content with the Defense Procurement Circular 57 administrative implementation rather than an amendment to Public Law 87-653.[1]

Mr. Minshall's H.R. 10573 (see Appendix B) was favorably reported out of Committee without amendment by both the Senate Armed Services Committee and the House Special Investigations Subcommittee. H.R. 10573 passed the House on May 6, 1968, and the Senate on September 11, 1968; it was approved on September 25, 1968.

ASPR changes

The administrative regulations implementing the Truth in Negotiations Act have not been as free from change as the Public Law itself. The ASPR and the other Governmental regulations that spell out procurement policy have been changed to keep pace with Board of Contract Appeals decisions and GAO interpretations. The decisions and their effects will be discussed in detail in Chapter III.

Summary

The Truth in Negotiations Act was the result of four years of legislative hearings, three proposed bills, numerous GAO blue-book reports, and hours of DOD, GAO, and industry testimony. What Representative Carl Vinson initiated as a means of controlling incentive contracting ended as legislation to control all Negotiated type contracts in excess of $100,000.

---

[1] Ibid., p. 7590.

The enacted Truth in Negotiations Act was acceptable to both GAO and DOD even though the former had fully supported the "incentive contract only" approach of Mr. Vinson. Congress appeared content with the legislation, and Mr. Vinson was reconciled to the broader coverage afforded by the revised H.R. 5532.

Opposition to the Truth in Negotiations Act has been centered principally on two points which have been discussed: (1) the "honest" mistake of the contractor in his certified cost or pricing data, and (2) offsets of over and underpricing to balance out price adjustments. Confusion has also arisen because of the GAO interpretation of the intent of the Act, especially on the latter point.

The advocates of PL 87-653 point out the legal concept upon which the law is based:

> That it is unjust to allow one who has made a misrepresentation, even innocently, to retain the fruits of a bargain induced by such representation.[1]

GAO believes that the Act provides a practical solution to the Government's problem of how to obtain fair prices where the normal economic market forces do not prevail.[2] This view of the Act is not held by industry, as stated by a spokesman for industry, the Senior Vice

---

[1]Robert F. Keller, "The Role of the General Accounting Office in the Enactment and Implementation of Public Law 87-653--The Truth in Negotiations Act," The Federal Accountant, XVIII (March, 1969), 87.

[2]Ibid., p. 88.

President of the Machinery and Allied Products Institute: ". . . the Truth in Negotiations Law is bad law, poor economics, and unsound procurement policy."[1]

---

[1]Charles I. Derr, Senior Vice President of Machinery and Allied Products Institute, "An Industry View of the Truth in Negotiations Act," The Truth in Negotiations Act ...A MAPI Symposium (Washington, D.C.: Machinery and Allied Products Institute and Council for Technological Advancement, 1969), p. 25.

CHAPTER III

IMPLEMENTATION

Introduction

The purpose of Chapter III is to discuss the various ASPR provisions implementing PL 87-653 as well as the important Armed Services Board of Contract Appeals decisions interpreting the Public Law. Government and industry implementing problems and a review of terms of the art that surround the Act will be presented along with a review of the steps being taken to improve implementation. The various publications utilized by Government and industry to implement, instruct, and maintain proficiency in the area of Government contracting will begin the presentation.

Unlike most laws passed by Congress, which are quietly administered after an initial breaking-in period, the Truth in Negotiations Act has been a source of continuous conflict. The basic idea of the Act is simple: the Government wants to know what the contractor knows or should know about the proposed costs. With an exchange of cost or pricing data knowledge both parties should be on an equal footing in the negotiation of a fair and equitable contract when competition or a market place is not available to set the price. Industry complains that the important aspects of

the Act are still uncertain and undefined after six years.[1] Gilbert Cuneo, a government contract lawyer of renown, contends that many of industry's problems stem from the constantly changing implementation regulations of the Act as set forth in the ASPR.

Procurement Regulations

Government publications

Although the Truth in Negotiations Act was initiated principally for the control of DOD and its defense contracts, the Act has subsequently been incorporated into the regulations of all other governmental agencies. The DOD contracting regulation, ASPR, promulgates the procurement policies and procedures established by the Armed Services Procurement Act of 1947 and its amendments. The ASPR is issued, at the direction of the Secretary of Defense, by the Assistant Secretary of Defense (Installations and Logistics) with the advice and recommendations of the ASPR Committee.[2]

Between published changes to the ASPR, revisions are issued in the form of Defense Procurement Circulars (DPC)

---

[1]Gilbert A. Cuneo, "The Practical Impact of Public Law 87-653 (Truth in Negotiations Act) on Primes and Subcontractors," The Federal Accountant, XVIII (March, 1969, 99-109.

[2]The ASPR Committee is composed of ten members: two from each service's Assistant Secretary of Defense (I&L), an Assistant Secretary of Defense (Procurement) from each service, and the Director of the Defense Supply Agency.

which remain in effect until incorporated into the manual. Additionally, policies, procedures, and general information are promulgated by DOD Directives, Instructions, and Manuals.

The ASPR is designed to achieve maximum uniformity throughout DOD as to policies and procedures covering the procurement of supplies and services. The ASPR is presently being implemented by:

Department of the Army
Department of the Navy
Department of the Air Force
Defense Supply Agency
Corps of Engineers.[1]

Industry media

In an attempt to keep abreast of the ASPR and its changes, there have been instituted several commercial publications. The publications are in the form of trade association memorandums, bulletins, and books. Two prominent trade associations are:

1. Machinery and Allied Products Institute (MAPI) and Council for Technological Advancement.
2. Aerospace Industries Association.

Other organizations, such as the Bureau of National Affairs (Federal Contract Report), Federal Publications, Inc. (The Government Contractor, Communique and Briefing Papers), and Commerce Clearing House (Government Contracts Guide and Government Contract Reports), publish well-known organs that report on the Washington procurement scene and provide studies and comments on current events affecting Government

[1]Commerce Clearing House, 1968 Government Contracts Guide, par. 168.

procurement and contracting.[1] The American Bar Association's Public Contract Law Section, the Federal Government Accountants Association, and the National Contracts Management Association are professional organizations that are also involved with Government contracting and publish journals on the subject.

Interpretation of the Law

Competitive process

The terms "adequate price competition" and "established catalog or market price of commercial items sold in substantial quantities to the general public" are terms of the art which have been precisely defined in ASPR.[2] They constitute exceptions to the general requirement for the contractor's submission of cost or pricing data, as required by PL 87-653, in negotiated procurements. If the following criteria exist, then competition exists and an adequate price based on this competition exists:

> . . . if offers are solicited and (i) at least two responsible offerors (ii) who can satisfy the purchasers (e.g., the Government's) requirements (iii) independently contend for a contract to be awarded to the responsive and responsible offeror submitting the lowest evaluated price (iv) by submitting priced offers responsive to the expressed requirements of the solicitation. Whether there is price competition for a given procurement is a matter of judgement to

---

[1]The Bureau of National Affairs, Inc., 1231 25th Street, N.W., Washington, D.C. 20037; and The Government Contractor, Federal Publications, Inc., 1725 K Street, N.W., Washington, D.C. 20036.

[2]ASPR, par. 3-807.1.

be based on evaluation of whether each of the foregoing conditions (i) through (iv) is satisfied . . . .[1]

Where competition is possible, price becomes the main consideration. Contracting officers rely on competition to establish the reasonableness of prices and then make awards to the lowest responsible bidder. Purchasing in a competitive market is not always possible. For example, during fiscal year 1968 the Navy Department experienced 3.7 million procurement actions, 99.7 percent of which were less than $100,000. The other .3 percent of the procurement actions accounted for 83 percent of the total procurement dollar expenditures. Dollarwise, 35.7 percent of Navy's $12,736,931,000 were competitive buys and 64.3 percent non-competitive (45.8 percent of the total expenditures were on one-source solicitations).[2] In these cases, reasonableness must be evaluated by means of either price analysis or cost analysis techniques.

When there is adequate price competition, cost or pricing data shall not be requested from the offeror regardless of the dollar amount involved.[3] As a general rule, cost or pricing data should not be requested when it has been determined that proposed "prices are" or are "based on" established catalog or market prices of commercial items sold

---

[1] Ibid.

[2] U.S., Department of the Navy, Headquarters Naval Material Command, Survey of Procurement Statistics (NAVMAT P-4200), June, 1968, pp. 10, 26.

[3] ASPR, par. 3-807.3(c).

in substantial quantities to the general public.[1] The existence of a catalog in itself is not sufficient; nor is the fact that an item is called "commercial" an indication that the price is reasonable. Quantity purchased, monopoly, and monopsony can influence the reasonableness of a price.

It is essential that contracting officers utilize some form of evaluation of contractor submitted prices in order to ensure price reasonableness. The method of analysis and the depth to which it is utilized depend upon the anticipated cost of the contract, the competitive situation, the "should cost," and the price source.[2]

Price analysis

Price analysis is defined by ASPR as the process of examining and evaluating a prospective price without the evaluation of the separate cost elements and profit of the individual prospective supplier whose price is being evaluated.[3] This type of analysis is the least expensive in terms of time and money for both the Government and the bidder alike. Price analysis may be performed in various ways:

1. Price quotation comparison.
2. Prior quotation comparison.
3. Use of a rough yardstick (i.e., dollars per pound or dollars per horsepower).
4. Comparison of proposed price with independently developed cost estimates.[4]

---

[1] Ibid.

[2] Reasonable expectation from past experience, inspection and common sense as to what the item "should cost" as against the current price charged.

[3] ASPR, par. 3-807.2. [4] Ibid.

If this analysis does not substantiate the bidder's quote, or the quote is deemed unreasonable, then cost analysis is required.

Cost analysis

Cost analysis, as distinguished from price analysis, is the process of projecting the effect of cost breakdown data (cost or pricing data) secured from the contractor or subcontractor in order to determine its effect on the quoted price. To be considered in this analysis are the effects of such cost factors as:

1. The necessity for certain costs.
2. Reasonableness of amounts.
3. Basis for allocation of overhead costs.
4. Appropriateness of the allocations of particular overhead costs to the proposed contract.[1]

Cost or pricing data

Public Law 87-653 stipulates that Government contracting officers "shall require the contractor to submit in writing cost or pricing data and to certify, by use of the certificate set forth in ASPR 3-807.4 [see Appendix C], that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete and current . . . ."[2] Appendix C contains ASPR paragraphs 3-807.3 through 3.807-5, which are pertinent to PL 87-653.

The cost or pricing data submitted and certified by the contractor includes all verifiable facts existing

---

[1]Commerce Clearing House, 1968 Government Contracts Guide, par. 939.

[2]ASPR 3-807.3.

up to the time of the contract price agreement that prudent buyers and sellers would reasonably expect to influence the price negotiations.[1] The certificate does not cover estimates but does apply to the data upon which the contractor bases his estimates of the cost of contract performance. Under a liberal interpretation of the Act, industry feels that the only way to comply is to present a "carload" of data to the contracting officer. Defense Procurement Circular 55, with its sample data submission and completed DOD Contract Pricing Proposal (DD Form 633), was a Government effort to clarify the ASPR data submission requirements. This was not a revision of regulations or procedures, but simply a restatement of previously intended but incorrectly interpreted ASPR language--in other words, a training tool.

The sample data contained in the DPC 55 is pointed to by industry as an example of the quantity and detail of data necessary to satisfy the Government. The DPC sample DD Form 633 consists of an actual eight-page Contract Pricing Proposal submission for the relatively "simple" procurement of a product that required the mixing of six purchased commodities.[2] If eight pages of detail are required for this admittedly "simple" proposal, it is argued by industry that the quantity of data required for a complex weapons system proposal can reach carload size.

---

[1] Ibid. The underlined words are words of limitation which definitize the broad wording of the Act.

[2] U.S., Department of Defense, Defense Procurement Circular No. 55 (Washington, D.C.: Government Printing Office, 1967).

Industry contends that ASPR places the burden of deciding what data are of significance for submission to the contracting officer entirely on the contractor. Ideally, if the contracting officer would specify the data he desires then the contractor could fulfill his responsibility by submitting that which was specified.[1] The contracting officer, on the other hand, cannot rely solely upon the contractor's submission and certification but must seek substitutes for the examination and analysis of the proposal.[2] Preaward audits as well as the utilization of other sources of data must be relied upon to ensure adequate data submissions.[3] Both parties must be active--the contractor in selecting the data he uses in compiling the proposal, and the contracting officer in testing the data.

Defective Cost or Pricing Data

ASPR requires that the data submitted in support of a Contract Price Proposal (DD Form 633) and certified by the contractor to be "all data that might reasonably affect the price negotiations . . . [must] be accurate, complete and current" as of the date when price negotiations were concluded and the contract price agreed to.[4] If, by audit

---

[1]Merritt H. Steger, "Some Aspects of PL 87-653--The Truth in Negotiations Act," Speech given at Federal Bar Association Briefing Conference on Government Contracts, Philadelphia, March 4, 1968.

[2]ASPR, par. 3-807.7.

[3]Ibid., par. 3-807.2(c)(3).

[4]Ibid., par. 3-807.5.

or other means, it is discovered that the certified data were inaccurate, incomplete, or noncurrent and resulted in an inflated contract price, the Government is entitled to a reduction in the contract price. In firm-fixed-price-type contracts this reduction includes a profit reduction, while in cost-type and incentive-type contracts the reduction is in price, profit fee, and/or reimbursable costs. This right to a price reduction is a contractual right contained in the clauses section of the contract.[1] The Government also contends that as a matter of fairness any price increase due to defective cost or pricing data is unearned; therefore, the contractor is not entitled to keep it.

The procedure for Government implementation of the Defective Pricing Clause is for the contracting officer to attempt to negotiate the amount of the reduction. The contracting officer's final decision, if not acceptable to the contractor, is appealable to a Board of Contract Appeals, the Comptroller General and the Court of Claims.

Armed Services Board of Contract Appeals Decisions

There have been nine significant Board of Contract Appeals (BCA) decisions that affect the implementation of the Truth in Negotiations Act; all have been made by the Armed Services Board of Contract Appeals (ASBCA):

---

[1] Ibid., par. 7-104.15.

1. American Bosch Arma Corporation (ASBCA No. 10305), December 17, 1965.
2. FMC Corporation (ASBCA Nos. 10095 and 11113), March 31, 1966.
3. Defense Electronics (ASBCA No. 11127), May 24, 1966.
4. Lockheed Aircraft Corporation (ASBCA No. 10453), May 18, 1967.
5. Cutler-Hammer, Inc. (ASBCA No. 10900), June 28, 1967.
6. Sparton Corporation (ASBCA No. 11363), August 25, 1967.
7. Honeywell, Inc. (ASBCA Nos. 12168, 12169, and 12170), November 25, 1967.
8. Bell and Howell Company (ASBCA No. 11999), April 15, 1968.
9. Aerojet-General Corporation (ASBCA No. 12264), April 29, 1969.

Each of these cases will be briefly outlined and the ASBCA decision will be presented.

The American Bosch Arma Corporation Case

The first decision issued by the ASBCA under the Defective Pricing Data clause is American Bosch Arma Corporation (ABA). The case arose on an appeal from a contracting officer's finding that the target price of a fixed-price incentive contract was overstated by $185,831, resulting in unwarranted profits of $45,529. The excess profits were due to the contractor's "failure to disclose" during contract price negotiations the current cost information that was reasonably available. The principal cost data involved were "available purchased parts prices" for about seventy-five different items.

In ruling on whether or not the government was entitled to a reduction of the contract price of $45,529

pursuant to the pre-PL 87-653 Equitable Price Reduction clause in the contract, the Board had to come to grips with the entire cost disclosure obligation and the DOD program of implementation.

The Board held in this Price Reduction Clause case:

1. The contractor certification requirement implied an obligation to furnish data which would show that cost estimates on materials, although correct on May 31, 1960, were too high as of September 28, 1960, when the contract price was negotiated.

2. Pricing data from vendor quotations dated subsequent to one month prior to negotiations were not reasonably available for the negotiations.

3. Any purchase orders or vendor quotes that could be found from examination of records, made available to Air Force auditors who examined them during audit, was considered disclosed to the Government.

4. Pricing data are "significant" if they would have any significant effect for their intended purpose, which was as an aid in negotiating a fair and reasonable price. Significance cannot be determined as a percentage of the total price. It should be noted that the reduction in cost of $20,746 amounted to approximately .13 per cent of the original target cost.

5. The Government has the burden of proof regarding the effect of nondisclosure of pricing data.

6. In the absence of more specific evidence tending to show what effect the nondisclosure of pricing data had on the negotiated price, the "natural and probable consequence" of the nondisclosure should be adopted as representing its effect. The record showed the Government relied on and utilized the pricing data submitted by the company.

7. The Government was entitled to a price reduction of approximately $5,500 which is based on target profit plus the incentive profit.

The FMC Corporation Case

The next case decided by the Board was the FMC Corporation (FMC). In this case, the Government contended that the contractor's firm-fixed-price contract should be reduced by a sum of approximately $400,000 pursuant to the pre-PL 87-653 Equitable Price Reduction clause in the subject contract. The grounds for the claim were based on an alleged failure to disclose:

1. Certain vendor quotes.
2. Information pertinent to the scrap recovery price of aluminum.
3. On-going experimentation which later affected a make-or-buy decision.
4. A "credit" for savings resulting from the successful experimentation.

The Board held:

1. The method of negotiation--agreement on total price or agreement on subsidiary cost--is immaterial to the effectiveness of the "defective pricing" clause in a firm-fixed-price contract.

2. The method of negotiation may become significant in determining whether the Government did in fact rely upon the data furnished or would have relied upon absent data in reaching agreement on price.

3. Continuation of previously unsuccessful experimentation on manufacturing methods does not constitute cost and pricing data which should have been disclosed in negotiations. Such experimentation should particularly not be included when negotiations look to a firm-fixed-price contract.

4. Significance of data is equivalent to its capability of being used for its intended purpose.

5. Scrap aluminum price data not disclosed was not significant because it would not have any practical effect on negotiation of either the price or contract type.

The Defense Electronics, Inc., Case

Of significance, Defense Electronics, Inc., is the first decision under clauses established pursuant to PL 87-653. The case involves an appeal from a contracting officer's decision that data not disclosed during the negotiation of a price adjustment for a change order to a fixed-price supply contract, an advertised bid situation, had led to an inflated contract price in the sum of approximately $400,000. The principal Government claim involved a failure to disclose data pertinent to a subcontract for key purchased parts.

The pivotal issue in the case was whether the Government could show the nondisclosure of data caused any increase in the negotiated price.

The Board held:

1. For the Government to have any valid claim, it must be established (i) that the contractor furnished inaccurate, incomplete or noncurrent pricing data, (ii) that the inaccurate, incomplete or noncurrent pricing data caused the price to be increased, and (iii) the dollar amount by which the price was increased as a result thereof. The Government has the burden of proving every element in the chain of proof necessary to substantiate its claim. The Government did not sustain this mandatory burden of proof and the contracting officer's decision was reversed.

2. When the contractor made data available to the auditor for his use in auditing the proposal, that was sufficient furnishing of data, and the contractor was under no obligation to furnish to the contracting officer, personally, data not requested by him which had already been made available to the auditor and which had been used and referred to in the audit report.

3. A clear distinction is drawn between "fact" and "judgment."

4. While the company failed to disclose significant pricing data, the Government has not sustained the burden of proving that the nondisclosure caused any increase in price.

The Lockheed Case

The appeal in this case was filed in the name of the prime contractor for Midwestern Instruments, Inc., a subcontractor whose pricing data were the basis of the dispute. The principal issue of the case was an alleged failure of the subcontractor to disclose certain cost data concerning material and direct labor costs, with a claim of over $200,000 involved. Verification of the subcontractor's proposal first submitted in February, 1962, included the following:

1. A price analysis conducted by the prime at the subcontractor's facilities on May 15 and 16, 1962.
2. The Air Force conducted its own price review in September, 1962.
3. In the fall of 1963, GAO reviewed the subcontract.

The Board held:

1. The subcontractor should have disclosed that in excess of 90 percent of the materials needed had already been purchased and significant reductions in material costs were experienced. The gesture allegedly made that all records were available was practically meaningless absent any inkling that specific significant data were in reality present and available. In ABA there was actual disclosure, as the auditor in fact physically examined the records and reported the results of the examination. In this appeal the Government auditors did not physically examine the purchase orders, and the pricing data made available were not complete or current.

2. The Government is bound by its examination of the limited records because there was disclosure to that extent.

3. With only 3 percent of labor cost incurred, the historical or factual data regarding the labor rate are too minimal as a basis for a violation of the defective pricing clause. The rate advanced by the subcontractor was projective and was not, nor was it intended to be, factual in nature.

4. "Offsetting" royalty and development cost items were only remotely related to the material costs in issue. The equitable reduction permitted under the defective pricing clause is intended to cover solely the cost items concerning which pricing data were defective. To permit unrelated offsets would be tantamount to repricing the entire contract.

The Cutler-Hammer Case

The appeal in this case involved a fixed-price-incentive-fee (FPIF) type contract containing the March 1963 "Price Reduction for Defective Cost or Pricing Data" (defective pricing) clause, which contains a reference to the certification requirement but does not provide for "equity" in the price reduction. As in Lockheed the timing involved was of significance.

The significant issues involving PL 87-653 were, first, whether the contractor could offset certain errors

of cost understatement against errors which served to overstate the contract price and, second, an alleged failure of the prime contractor to disclose a quotation for a component which was significantly lower than the quotation actually used in negotiations.

The Board held:

1. Offsetting omissions in material pricing, in no instance due to the improper extrapolation of quantities, are not available for offset. PL 87-653 was intended solely as a vehicle for recoupment by the Government of overpricing.

2. A significantly lower bid from an unproven vendor, not disclosed to the Government, was far from being data upon which a firm price reduction would have been reached; but this information was significant from the standpoint of overall contract negotiation.

3. The burden on the Government of proving the causal relationship between significant, nondisclosed, pricing data and the resulting price reduction is not intended to be an "unreasonably heavy" one.

The Sparton Case

The contracting officer under two Navy contracts had determined in accordance with the terms of the Defective Pricing clauses that Sparton Corporation owed the Government approximately $2.4 million on the grounds that Sparton had furnished pricing data which it knew or

reasonably should have known were false and misleading, and that it had failed to disclose other significant data.

The Board held:

1. The Material Price Analysis (MPA) submitted in support of the contractor's price proposal contained erroneous information that was correctly available in the contractor's records and from his engineers; therefore, the contractor should have known that the MPA was erroneous and could mislead the Government.

2. The "defective pricing" clause is not designed to correct errors that result from approved contract changes that take effect under contract award.

3. A price overstatement and quantity understatement was considered not to be a false statement nor in conflict with previous decisions relating to offsets.

4. Whether the price has been overstated or the Government has been misled is not to be determined solely on the basis of the MPA. Other evidence such as DD Form 633 and working papers must also be considered.

5. Vendor quotes must be disclosed to the Government if they can "reasonably be expected to have a significant bearing on costs under the proposed contract." In order to establish contractor liability the Government must establish that at the time the data are submitted the contractor did not intend to do business with the vendor listed in his proposal but with the low-cost vendor.

Honeywell, Inc., Case

This case involves an appeal of the Government's claim that Honeywell, as a subcontractor, had concealed and misrepresented cost data in price negotiations and thereby had overcharged the prime Government contractor. The prime contractor had assigned to the United States such claims as it might have against the subcontractor for misrepresentation or concealment of cost or pricing data. Therefore, Honeywell, the subcontractor, has no privity with the Government and thus no standing before the Board.

The Board held:

1. However effective and valuable to the subcontractor the opportunity to participate in or secure from the prime contractor the latter's right of appeal may be, it is difficult to view that opportunity as an independent right of the subcontractor.

2. Even if the Board had authority under some circumstances to nullify this type of appeal right assignment on the grounds that it is unauthorized (a question which the Board expressly did not decide), such authority may not be exercised at the insistence of a subcontractor that has entered into no agreement with the Government or the prime contractor which designates the Armed Services Board of Contract Appeals as the referee for contract disputes.

Bell and Howell
Company Case

An initial fuze order was negotiated on a fixed-price incentive contract which was subsequently modified by an additional quantity. The contract was revised and became a firm fixed-price contract. The Government contended that at the time of the modification the contractor had possession of six low subcontractor bids which were not disclosed. Bell and Howell contended that at the time of contract negotiation there were valid reasons not to place the orders with the six vendors and that this information had been orally passed to Government representatives.

The Board held:

1. The six low quotes, not disclosed to the Government during negotiation of a contract modification, are considered cost or "pricing data." The contractor was actively and vigorously engaged in negotiations with and making plant surveys of the low quote vendors.

2. It is unrealistic to assume that the six low quotes from untried sources would be completely reliable. Experiences under prior contracts indicate a serious risk in entering into firm-fixed-price contracts for these fuzes.

3. If quotes disclosed, the most likely effect would have been to cause the negotiators to conclude that the risk was too high to shift from the fixed-price incentive contract.

4. Probable consequence would have been a 60/40 sharing arrangement on cost overruns as in the original contract. Accordingly, the Government is entitled to 60 percent of the savings realized from use of the six low quotes.

5. These rules are not intended to be findings of what would have happened if there had been a disclosure of the low quotes. Rather, they are intended to be a basis for determining the probable effect of the nondisclosure on the price. This is a situation where the nondisclosure is bound to have a significant effect but it is impossible to determine the precise effect.

Aerojet-General Corporation Case

The Government claims entitlement to a reduction of more than $500,000 in the target cost of the prime contract, together with appropriate adjustments in the other pricing elements, on the grounds that the contractor did not furnish accurate, complete, and current cost data concerning the costs of nozzles being manufactured by its subcontractor, Straza Industries (hereinafter referred to as Straza).

The contractor contends that it submitted to the contracting officer accurate, complete, and current cost data as of the date it executed a "Certificate of Current Cost or Pricing Data" and furnished it to the respondent.

The contractor contends further that the Government did not rely upon the contractor's cost or pricing data relating to the nozzle procurement.

The Board held:

1. Prior to the commencement of negotiations with the Government and prior to the date of execution of the "Certificate of Current Cost or Pricing Data," the contractor had conducted engineering analyses and studies on the basis of which it had determined that Straza's quotations of extra costs for nozzle changes were significantly overstated.

2. The cost analysis which the contractor furnished the Government, and which it certified to, contained the price quotations by Straza which were significantly overstated; knowledge of the overstatement was reasonably available to the contractor on or before the latter date.

3. The contractor did not include with its submission of cost and pricing data any reference to or copies of the engineering analysis, cost estimates, or other data which would have disclosed the contractor's conclusion that Straza's prices were significantly overstated.

4. Negotiators proceeded upon the erroneous assumption that the cost or pricing data furnished the Government on October 10, 1962, and updated through December 4, 1962, were accurate, complete, and current, and that both parties used the cost data, including the data relating to the nozzles, as a basis for the negotiations.

Interpreting the ASBA decisions

A view of the nine ASBCA decisions and their interrelationships will give a better understanding of the Board's decision process and their view of the Truth in Negotiations Act. The Board's decisions can also give an insight into the implementation of PL 87-653.

The sequence that best applies to this survey follows the questions that the Government must answer in proving its price reduction case for defective cost or pricing data. The questions are:

1. What constitutes cost or pricing data that must be submitted?
2. Were the data actually submitted?
3. Were the data certified to be accurate, current, and complete?
4. What was the effect of the defective data; was the effect significant?
5. Were the data available when required?
6. Are offsets allowed?

The answers to these questions have resulted in varied findings by the Armed Services Board of Contract Appeals. Each question will be discussed separately.

1. What constitutes cost or pricing data that must be submitted?

The Sparton case illustrates the responsibility of the contractor to submit data which should reasonably be expected to have a significant effect on costs.[1] The Board has held that it is not necessary for the contractor, at the time of data submission, to submit vendor quotes that

[1] ASPR, par. 3-807.3(e).

are not intended to be utilized. This holding is contrary to ASPR and Cutler-Hammer in that low quotes, whether unsolicited or not, were a required part of the data submission. This test of data does not follow a formula but rather must be viewed in light of the negotiation situation. There is also the differentiation between "fact," which is submissible, and "judgmental" information, which is data upon which the contractor's judgment is based and need not be submitted.[1] The FMC case demonstrated the "fact" versus "judgment" distinctions with regard to the make-or-buy situation.

In Aerojet-General, engineering analysis and/or studies which revealed significantly overstated subcontractor quotes were not disclosed as cost or pricing data. Neither Government or contractor negotiator knew of the contractor's studies, but this was held immaterial since it was reasonably available. Of interest here is that although the estimates had judgmental factors, these were not controlling. The contractor would not be held responsible for "judgment" errors--only errors of "fact," which is what the studies were.

2. Were the data submitted?

In addition to determining what data are to be submitted, the question of what constitutes "submission" arises. In ABA the "making available" of data to auditors was held

---

[1] Ibid.

to satisfy ASPR. ASPR was subsequently changed to remedy this loophole. After the ASPR revision, in FMC and Lockheed, the fact that fifty Government auditors were in residence at the plant site or that the records were available was irrelevant to the submission requirement. The Government's position is that "making available" of records would relieve the contractor of the responsibility to submit the information that would give the two parties to the negotiation equal knowledge, which was the original intent of the Act.

3. Were the data certified to be accurate, current, and complete?

In the ABA and Lockheed cases, contracts were negotiated prior to the passage of PL 87-653 and, therefore, did not tie-in the price reduction clause with the contractor executed certification. Thus, dependence was not predicated upon the certification for the ASBCA price reduction decision. These decisions, then, cannot be used as guides today. At present, the certificate is an integral part of the price reduction clause for defective cost or pricing data. In cases where the contractor is not required to certify data (when there exists adequate price competition or the item is listed in an established catalog or there exists a market price for the commercially sold item to the general public) there is little likelihood of contractor liability.[1]

---

[1]Gilbert A. Cuneo, Robert L. Ackerly, and John Lane, Jr., "Truth in Negotiations--Part II: Submission of Cost and Pricing Data, Audit, Remedies, and Subcontractor Problems," Briefing Papers, No. 68-4, The Government Contractor (Federal Publications, Inc., August, 1968), p. 4.

4. What was the effect of the defective data; was the effect significant?

In ABA and Lockheed the "natural and probable consequences" of the defective data upon the price can be presumed to be, in the absence of evidence, that defective data were used. This does not shift the problem of proof from the Government to the contractor, but, rather, shifts the burden of going forward with the evidence to the contractor. It establishes a rebuttal presumption. In the Bell and Howell case the Government proved defective data and the contractor did not prove nonreliance. The Board found that the burden of proof had remained with the Government and the consequence of the defective data did not increase the price dollar for dollar.

The ruling in one aspect of the Defense Electronics case was that the Government had not sustained its burden of proving that a nondisclosure caused a price increase. This decision was the "probable consequence" as reasoned by the Board from the facts presented.

In addition, the dollar amount of the increase in price resulting from the defective data must be established in order to "reduce accordingly." Here, the difficulty arises when the negotiations are on the total costs and not on specific cost elements. In Cutler-Hammer and ABA the Board held that the amount of the defect is equivalent to the price reduction, whereas in Sparton the Government settled for a 60 percent sharing of the saving from

utilization of the undisclosed low bids since, if disclosed, a 60/40 sharing of the risk would have been probable.

The term "significant" as applied to nondisclosed data appears when a price reduction is discussed. ABA held that significance cannot be determined as a percentage of the cost.[1] In FMC and Defense Electronics, the Board explained that "significance of data" is a subjective test to be applied in light of the facts of the negotiating situation, i.e., its use as an aid in negotiation. Industry feels that this test of significance is in reality a test of hindsight.

5. Were current data available when required for negotiations?

The establishment of the period of time during which the contractor is obligated to disclose cost or pricing data is the fifth item in the sequence. The "reasonable availability" of vendor quotations has fluctuated from a period of less than thirty-four days prior to price agreement in ABA to twenty-one days in Lockheed, and to thirteen days in FMC in the instance of a scrap aluminum price. The use of an "as of" date in the certification removes uncertainty about the date the data are required.

6. Are offsets allowed?

Essentially, the problem is: If cost or pricing data are defective in several respects, some increasing the

---

[1] In ABA the reduction amounted to .13 percent of the original target amount, whereas in FMC the amount was .16 percent and was considered "not significant."

price and others decreasing the price, can the increase or decrease be netted so as to offset each other and thereby lessen the price reduction? An offset was denied in Lockheed, but industry felt that in the future the Board might consider limited offsets in the case of related "overs" and "unders."[1] This hope was removed in Cutler-Hammer when the Board flatly denied offsets. The Board concluded that the Congressional intent of PL 87-653 was to act as a recoupment vehicle for the Government in cases of overpricing. It is argued that the no-offset rule prevents the contractor from repricing the contract. To permit offset would be to blunt the bite of the Act.

The Sparton case disregarded the Board's previous decision in Lockheed and Cutler-Hammer by permitting the offset of an overpriced tube with the understating of the quantity of tubes required. The Sparton case has confused industry and Government alike regarding the application of the no-offset rule. The ASPR permits offsets of the Sparton type, and industry agrees that PL 87-653 provides for only downward price adjustments. This confusion should be settled when the Court of Claims hands down its decision on the subject, the first review of a Truth in Negotiations case.[2]

---

[1]Machinery and Allied Products Institute, "Government Contracts: Truth-in-Negotiations Law," Memorandum GC-22, July 24, 1967, p. 16.

[2]Cutler-Hammer, Inc. v U.S., Court of Claims 364-67.

Implications of Board Decisions

A General Counsel of the Navy Department offered his opinion that "on the whole industry thus far has not fared too badly under the law and that both Government and industry are learning to live with the law." He also feels that the ASPR changes have "clarified" and "definitized" the Act and codified the applicable rulings.[1] After the first three ASBCA decisions in the price reduction, data disclosure area, an industry publication tends to concur:

> If a single characterization were appropriate, it would be fair to say that the Board is apparently trying to make manageable what might be otherwise an unmanageable requirement.[2]

More recently the same organization has observed that the ASPR and the Board decisions "ignore the practical difficulties inherent in defining data, identifying those data really required and the submission difficulties which attach."[3] Industry points out that there are many unanswered questions which impede implementation of the Act. The questions which it is felt are unanswered by ASPR or ASBCA decisions are:

1. Does a contractor's offer to submit data prior to agreement on price, whether or not accepted by the Government, satisfy the disclosure obligation?

---

[1] Steger, "Some Aspects of P.L. 87-653," p. 5.

[2] Machinery and Allied Products Institute, "Government Contracts: The Cost or Pricing Data Submission Program," Memorandum GC-17, July 27, 1966, p. 6.

[3] Machinery and Allied Products Institute, "Government Contracts: Truth in Negotiations Law," Memorandum GC-22, July 24, 1967, p. 20.

2. When are data to be regarded as "actually disclosed" and must there be identification of specific data?

3. What obligation does the Government have to request data specifically when the availability and pertinency of such data are obvious at the time of price negotiations?

4. Are unused low bids to be submitted as required by ASPR when they fail the "significance" test and are held unnecessary by Sparton?

Confusion

Part of the confusion that afflicts the implementation of the Act stems from the changing ASPR regulations as well as Congressional and GAO pressures on DOD to tighten regulations. These problems are the result of the conflicting ASBCA decisions. Questions answered by today's Board decision appear unanswered tomorrow. Cuneo views the ASBCA decisions as being consistently in favor of the Government.[1] He further states that he cannot "recall any other instance where ambiguities in the application of a statute have so consistently and uniformly been construed against the public."[2] The only salvation that industry spokesmen see for the Act is for the ASBCA decisions to be reviewed by a court and the earliest court review is at least a year away in the Cutler-Hammer case on offsets.

---

[1] Cuneo, "Practical Impact of Public Law 87-653," pp. 99-100.

[2] Ibid.

The Corporate Director of Contract Policy and Planning at the Boeing Company points out that the Act is self-enforcing through the rewriting for implementation of the act in ASPR to give the Government the benefit of the doubt:

> When the government shows that something which will be called "data" existed prior to negotiations, was either known to or should have been known to the contractor, could have affected the negotiated price in the government's favor, was not identified through auditable documentation to the negotiator for the government, the contractor must pay back the amount of a presumed overpricing unless he can prove that the result of the negotiation would have been either less advantageous to the government or entirely not the government's disadvantage. So says the law as it is now implemented.[1]

A representative of Sundstrand Aviation feels that industry is being forced into a situation where it is becoming more important to justify and protect its negotiation position than to get a fair and reasonable price.[2]

Critics and supporters alike contend that in spite of the problems and the criticisms of the Act, it is here to stay. It also appears that the implementation of the Act is building a mutual hostility between Government and industry. Nevertheless, there must be mutual respect as well as mutual need between customer and supplier in addition to ethical practices by both parties. The Deputy Director of DCAA, Bernard B. Lynn, believes that criticism of the "law and its administration have just about peaked," and that the

---

[1]John A. O'Hara, "Living with the Law," in The Truth in Negotiations Act...A MAPI Symposium, pp. 160-68.

[2]Kenelm A. Groff, Jr., "Living with the Law," in ibid., p. 171.

new efforts to train and supervise DOD contract personnel and revise the ASPR will improve administration of the law.[1]

Implementation

The best characterization of the implementation problem is that there is substantial confusion between the objective of the Act as it was passed--the objective of truth in negotiations--and what is actually happening in the administration of the Act in an attempt to achieve this objective.[2] It appears that rather than achieving the objective of getting all the necessary information on the negotiation table, GAO is more interested in an audit trail. This policy relegates the actual negotiation and a resulting fair and reasonable price to a secondary position. This preoccupation with audits could be due to the Accounting versus Procurement influence in GAO.

Nash suggests that the way the implementation of the Act is headed the probable result will be (1) perfect documentation and an inability to arrive at a price; (2) an overkill of the implementation, especially auditing from a cost effectiveness standpoint; and (3) the dilution of preaward audit efforts by postaward activity.[3]

These observations are supported by the continuing GAO efforts to revise the implementation procedures by

---

[1]Bernard B. Lynn, "Contract Audits Under the Truth in Negotiations Act," in ibid., pp. 139-52.

[2]Ralph C. Nash, Jr., "The Future of the Truth in Negotiations Act," in ibid., p. 189.

[3]Ibid.

revising the ASPR. The blue-book reports are a prime example of the pressure applied by GAO to influence Congress for stronger legislation and to force DOD to tighten the implementation of the Act through ASPR revisions.

Summary

The answer to the subsidiary question "Has the law been fully implemented by Government and accepted by industry?" can sum up Chapter III.

The discussion in Chapter III shows that since 1962, when the Truth in Negotiations Act was passed by Congress, there have been significant changes in the regulations that implement the Act. The changes have been brought about by conflicting as well as complementary ASBCA decisions, GAO efforts to bring the ASPR more in line with its interpretation of the original Act, amendments to the Act itself as a result of GAO reports of industry noncompliance, and finally, by the ASPR committee's effort to make the ASPR more effective, uniform, and equitable in administering the Act.

The effect of the past seven years of conflict has been that the implementing regulations have been kept in a state of perpetual motion. The Act needs time to settle in order to be fully implemented and time has not been given to it.

CHAPTER IV

PREAWARD AND POSTAWARD

Pre-contract award and post-contract award audits of contractor records by the Defense Contract Audit Agency (DCAA) will be discussed in this chapter. DCAA's authority to perform audits of contractors' records, the purpose of the audits, and their effect on the implementation of PL 87-653 will be explored. A brief background sketch of DCAA will precede the discussion.

The Audit Agency

Background

Prior to 1965 the individual armed services and the Defense Supply Agency of the Department of Defense supplied their own individual auditing staffs to perform contract audits on contractors and subcontractors who were vying for, or had been awarded, government contracts. This duplication of contract administration effort within the Department of Defense was terminated with the establishment of the Defense Contract Audit Agency (DCAA) on July 1, 1965, by a Department of Defense Directive issued by Secretary of Defense Robert S. McNamara.[1]

---

[1] U.S., Department of Defense, Defense Contract Audit Agency, Department of Defense Directive 5105.36, July 9, 1965.

The DCAA consists of a Headquarters located at Cameron Station, Alexandria, Virginia, and seven regional offices located in Boston, New York, Philadelphia, Atlanta, Chicago, San Francisco, and Los Angeles. As the Defense Department's only face to industry in auditing matters, DCAA conducts audits on more than 4,800 businesses, universities, and other institutions. By September 1968 there were a total of 3,900 DCAA employees, and of this number 400 were Certified Public Accountants. The Agency audited $24 billion in cost incurring contracts and evaluated 21,600 prospective price proposals.[1] In addition to the seven regional staffs, there are resident audit staffs located at the plants of the larger Government contractors. There are also local DCAA branch offices located in areas of high industrial density to cover the smaller contractors and subcontractors.

The DCAA was founded, with the mutual concurrence of all the Defense agencies, by the consolidation of the various separate auditing staffs under one director, who is responsible directly to the Secretary of Defense. The consolidation was also welcomed by industry, who would then have to deal with only one agency on audit matters. Concrete advantages would also accrue because of the elimination of duplication, its attendant inefficiency, and higher costs.

---

[1] U.S., Department of Defense. Defense Contract Audit Agency, Fact Sheet on Defense Contract Audit Agency, September, 1968.

Role of DCAA

DOD's implementing directive defines the purpose of the DCAA:

> The basic purpose of contract auditing is to assist in achieving the objective of prudent contracting by providing those responsible for procurement and contract administration with financial information and advice on proposed or existing contracts and contractors, as appropriate. Audit services of the DCAA shall be utilized by procurement and contract administration activities to the extent appropriate in connection with the negotiation, administration and settlement of contract payments or prices which are based on cost (incurred or estimated), or on cost analysis.[1]

The intent of the implementing directive is to task DCAA to perform the audit functions required by contracting and procurement officials in DOD. The audits will assist the purchasing officers in carrying out their functions in an efficient, timely, and professional manner, to the best advantage of the Government. These auditing functions are performed during the entire life cycle of a procurement, from preaward audit to postaward audit to final payment, which includes the audit and other financial aspects of contract and subcontract negotiation, administration, and settlement.

Audit authority and responsibility

The auditing of defense contracts is the responsibility of the Director of DCAA, within the limits prescribed by the Contract Audit Manual of DCAA. The contracting

---

[1]Department of Defense Directive 5105.36 (1965).

officer is required by ASPR to request an audit review of the cost or pricing data submitted on the Contract Pricing Proposal (DD Form 633) by DCAA prior to negotiation, change, or modification of a contract. The exceptions to this requirement apply if the contract, change, or modification:

1. Is not expected to exceed $100,000.
2. Is based on adequate price competition.
3. Is based on established catalog or market price of items enjoying substantial commercial sales or is based on a price set by law or regulation.
4. Is based on the head of agency's written waiver.
5. Is less than $100,000 if there is no satisfactory method of price analysis--this is discretionary.[1]

DCAA is not responsible for selecting contractors' proposals to be audited or when to waive audits. It is DCAA's task to make pre-contract award audits when requested by the contracting officers, as fully as possible and prior to the completion of the negotiation of the contract. However, when it is necessary to provide assurance that defective cost or pricing data were not submitted, audits should also be conducted of actual costs incurred after the contracts are consummated.[2] The ASPR now provides for the inclusion of a clause in noncompetitive firm-fixed-price contracts as well as the previously specified cost type contracts involving certified costs or pricing data that will ensure a contractual right of DCAA to access to the

---

[1] ASPR, par. 3-807.

[2] Defense Procurement Circular No. 57, Deputy Secretary of Defense Paul H. Nitze Memorandum, September 29, 1967, p. 3.

contractor's actual performance records.[1] Situations which may require the use of the postaward performance audit might include such cases as:

1. Urgency in placing the initial procurement limited the time allowed for the preaward audits.
2. Material costs are a significant portion of the contractor's total cost estimate.
3. Substantial subcontracting of the contract.
4. Substantial interval between pre-contract cost evaluation and agreement on price.
5. Contractor's failure to disclose all available data or, if it became available after the audit.[2]

Without the benefit of after-the-fact performance data, DOD is often unable to verify that all appropriate data were furnished in the negotiation and that the contractor performed as represented at the outset.[3]

GAO discovered in its postaward audit reviews in 1965 and 1966 that certain cost information was not disclosed by contractors or it became available after preaward audits were performed.[4] This led to the conclusion that preaward audits were not entirely effective in disclosing

---

[1]ASPR, par. 7-104.41.

[2]House, Subcommittee Hearings on Review of Defense Procurement Policies, Part I (1967), pp. 38, 44.

[3]U.S., Congress, House, Review of Defense Procurement Policies, Procedures, and Practices, Part I: Truth in Negotiations, Report of the Subcommittee for Special Investigations, 90th Cong., 2d sess., February 29, 1968, p. 10.

[4]U.S., General Accounting Office, Need for Postaward Audits to Detect Lack of Disclosure of Significant Cost or Pricing Data Prior to Contract Negotiation and Award, Report to Congress, B-158193, February 23, 1966, pp. 1-2.

cost estimates that were excessive, in light of information available, at the time of negotiation and contract award. Postaward audits were effective in disclosing this information and in determining the extent of contractor compliance with PL 87-653. Postaward audits also provided a basis for price adjustments under the defective pricing data clause of the Truth in Negotiations Act. The effectiveness of postaward auditing prompted GAO to recommend to the Department of Defense, and report to Congress, that a systematic DCAA postaward review program be instituted. Up to this time DCAA's Contract Audit Manual provided for only general surveillance of this area and not for regularly scheduled postaward reviews.[1]

Preaward Audits

The requirement

As a result of PL 87-653 contractors are required to submit cost or pricing data under certain conditions, which have been discussed earlier, and to certify that such data are current, accurate, and complete. The law also provides for downward price adjustments, in favor of the Government, if it is discovered that any defective data had significantly increased the negotiated price of the contract.

It is DCAA's primary mission to perform the preaward audits and not to wait until the contract has been awarded to begin to search for defective pricing in a postaward audit.

---

[1] Ibid.

Scope of audit

The ASPR requires the contracting officer to determine the requirement for, and to request an audit review of contractor submitted price proposals. It then becomes the DCAA auditor's responsibility to conduct the audit review of the contractor's actual or estimated costs. The depth of the audit is determined by the auditor, relying on his experience with the contractor and utilizing appraisals of the effectiveness of the contractor's purchasing policies, procedures, controls, and practices.[1] Audit reviews or audits may consist of desk reviews, test checks of a limited number of transactions, or examinations in depth, at the discretion of the auditor.[2]

Postaward Audits

Why postaward auditing?

In order to comply with the recommendations of GAO and to rectify the paucity of defective pricing reports that GAO felt should be flowing back to contracting officers as a result of postaward audits, DCAA promulgated a regulation in March of 1966. This regulation, entitled "Performance of Defective Pricing Reviews," defined the DCAA role in assisting in the implementation of PL 87-653. The "Review" regulation discussed the institution of a DCAA regularly

---

[1] ASPR, par. 3-809.

[2] Ibid.

scheduled postaward program of audits to determine contractor compliance with the contract certification that complete, current, and accurate cost data had been submitted. The scope and extent of this program is dependent upon the availability of auditors and the number of price proposals, which have priority and must be accomplished first.

How performed?

DCAA's postaward audit objective is to make a factual determination, not investigative, concerning the data submitted and certified by the contractor prior to contract award. Upon completion of the audit, and if required, an "advisory" report evidencing "apparent" defective pricing is forwarded to the contracting officer for his action, legal proceedings and/or further investigation, and final disposition.

The volume of price proposal audits, which are especially heavy because of Vietnam requirements, leave little time for the implementation of the "review" program. The following criteria are utilized in selecting contracts for audit in order to choose those contracts with the highest probability of defective data:

(a) significant cost underrun,
(b) contract amounts and product complexity,
(c) information gained in the performance of initial pricing reviews and from the records of contract negotiations furnished in accordance with the ASPR (absence of initial pricing reviews, restriction on the scope of such reviews, evidence of undisclosed or unsupported costs included in the contract price),

(d) information gained in other audits indicating the possibility that certain pricing data were defective.
(e) refunds or allowances tendered by a subcontractor to a prime contractor are included in this category,
(f) contracting officer requests.[1]

Some of the specific points that are inspected and which would tend to indicate defective cost or pricing data are:

(a) significant decreases in component costs,
(b) operations not actually performed, or costs not in fact incurred,
(c) evidence on the part of the contractor that he could reasonably expect to buy components for less than the price proposed,
(d) failure to reflect the benefits of management, production and budgetary decisions which must have been known to management,
(e) whether prime contractors have used defective pricing clauses in their subcontracts,
(f) recorded costs, when pertinent,
(g) vendors' quotations,
(h) purchase order dates,
(i) refunds and credits from suppliers.[2]

Prior to the publication of the DPC 57 revision of ASPR in November, 1967, it was not possible for Government auditors to perform postaward audits on firm-fixed-price contracts involving certified cost or pricing data. The House Subcommittee for Special Investigations found that several contractors had taken a position that they were not obligated to use or supply available costs of prior performance for the pricing of follow-on contracts, although

---

[1]Willard O. Vick, "Role of Defense Contract Audit Agency under Public Law 87-653," Public Contract Law Journal, I, No. 2 (July, 1968), 61.

[2]Ibid.

the cost records were pertinent to the contract.[1] After contract award the contractor would contend that PL 87-653 and the terms of negotiated firm-fixed-price contracts did not entitle DCAA in particular, or the Government in general, to examine records from completed contracts.[2] The subcommittee felt that this secrecy deprived the Government of a valuable tool for the verification of contract prices and the feedback that would improve contract negotiating, auditing, and evaluation of proposals. The Department of Defense acceded to a GAO recommendation for such audit access, resulting in issuance of DPC 57. Secretary Nitze reiterated that it is "and remains the policy of Department of Defense that in firm fixed-price contracts the cost and profit consequences are the full responsibility of the contractor since he assumes all the risk of performing in accordance with the contract."[3] Secretary Nitze further stressed that postaward audits are for one purpose and one purpose only, i.e., "determining whether or not defective cost or pricing data was submitted." Repricing of contracts or profit versus cost ratios are not to be evaluated unless there is defective cost or pricing data.

---

[1] House, Report on Review of Defense Procurement Policies, Part I (1968), p. 9.

[2] Ibid.

[3] Defense Procurement Circular No. 57, p. 3.

Industry has become concerned about the rewording of the ASPR clause that gave DCAA

> the right to examine those books, records, documents, papers and other supporting data which involve transactions related to this contract or which will permit adequate evaluation of the cost or pricing data submitted, along with the computations and projections used therein.[1] (Italics mine.)

Secretary Nitze's comments notwithstanding, some DOD officials believe that the language of this clause will extend audit access to records on the sale of the commercially equivalent items on the commercial market.[2] It is observed from this concern on the part of industry that there might be justification on the part of the Government to "full disclosure" and for postaward audit of data "which involve transactions related to this contract."

If profits are increased, costs reduced by effective management or savings device and PL 87-653 has been complied with, there will not be a recomputation of the contract price. Costs and prices are a matter worthy of note and if known to all contracting officers could save the Government money on other contracts for like items. For this reason GAO and DCAA feel justified in holding contractor record reviews at any time up to the three-year date of expiration of the statute of limitations.

---

[1]ASPR, par. 7-104.41.

[2]Machinery and Allied Products Institute, "Government Contracts: Truth-in-Negotiations Law," Memorandum GC-24, December 7, 1967, p. 13.

Contractor Records

Access to records

In order for the DCAA auditor to carry out the required audits and formulate an informed opinion, the auditor must have access to those substantiating documents that support both factual and forecasted cost data. In addition to historical data, the availability of vendor quotations, unit cost trends, make-or-buy decisions, or other management decisions which could reasonably be expected to have a significant bearing on proposed costs could be required by the auditor and should be made available.[1]

Denial of access to records

A recent GAO Report to Congress on a DCAA survey of Contractors Price Proposals, subject to PL 87-653, discussed the access-to-records problem.[2] The types of records that were restricted by the contractor included historical data, vendor material quotations, and supporting documents for overhead rates. A DCAA internal report of 164 locations disclosed that from their experience budgets, financial statements, tax returns, boards of directors' minutes, and

---

[1] ASPR, par. 3-807.3.

[2] U.S., General Accounting Office, Survey of Reviews by the Defense Contract Audit Agency of Contractors' Proposals Subject to Public Law 87-653, Report to Congress, B-39995, February 15, 1967, p. 36.

internal audit reports were restricted more often than individual cost records.[1]

It is not possible to state categorically what records can and what records cannot be audited by DCAA. There are virtually no helpful precedents in this area, because disputes are almost always resolved on a case-by-case basis without litigation. The one court decision pertinent to the access-to-records question was the Hewlett-Packard case, which affirmed contract "Examination of Records" clauses and gave GAO the right to examine all "directly pertinent" books and records "involving transactions relating to this contract" including production records in the procurement of a commercial item.[2]

The contractor grants to the contracting officer or his representative the right to examine the substantiating records, by his submission of the proposal, i.e. the DD Form 633. Despite the ASPR and DD Form 633 enumeration of the types of records to be made available to Government auditors, the access-to-records problem was determined to be the result of differing interpretations by agency auditors and contractors.[3]

---

[1] Ibid.

[2] Hewlett-Packard Co. v. U.S., 385 F.2d 1013 (C.A. 9, 1967), 9 G.C., par. 461, cert. denied 390 U.S. 988 (1968), 10 G.C., par. 117.

[3] GAO, Report to Congress, B-39995, February, 1967, p. 33.

Access-to-records controversies delay procurement, frustrate negotiations, and tend to build up mistrust between the Government and contractors as well as qualify the auditor's reports. If the records controversy cannot be resolved at the audit site it should be referred to a centralized DCAA group at the Cameron Station DCAA Headquarters where the problem can be dealt with on a more uniform and effective basis. If DCAA Headquarters is unable to resolve the impasse, then the Office of the Secretary of Defense should be asked for assistance.[1]

The Government contends that whatever records are disclosed to it are kept in confidence; nevertheless, "industry fears its proprietary information will be jeopardized by giving postaward audit authority to the Defense Department."[2] Despite industry reluctance to concede, DPC 57 was instituted.

Summary

The proper and effective functioning of PL 87-653 is predicated upon complete, current, and accurate cost or pricing data submissions by contractors. Experience has shown that errors of all types can creep into the submitted proposals and that the data submitted can change due to market conditions, quantity, or other requirement changes.

---

[1] Ibid., p. 36.

[2] "DOD to Start Post-Award Audits," Aviation Week & Space Technology, LXXXVII (December 4, 1967), 26.

Because of these factors the role of the DCAA contract auditor has assumed vital importance to the overall procurement cycle. His informed reports, if timely and unqualified, are essential to effective contract negotiation.

It has been stated that the purpose of pre- and post-contract award audits is to determine the validity of contractor submitted cost or pricing data. The validity of the data as it relates to the determination of the contract target price is the ultimate test of whether defective data were submitted. The only purpose of the audits, then, is to ensure that the data submitted were not deceptive. Audits are not motivated by a desire to recoup profits that resulted from technological breakthroughs, ingenuity, or improved production methods. Cost underruns themselves do not equate to defective pricing. Even if an underrun is the result of overestimates in the contractor's proposal, defective pricing is not the culprit unless there was a defect in the factual data submitted.[1] The Government is not requiring the contractor to certify his "judgment as to the estimated portion of future costs or projection," only to fact.[2]

How effective Government contract negotiations have been remains to be determined by the postaward audits conducted by DCAA. In addition to determining the validity

---

[1] ASPR, par. 3-807.3.

[2] Ibid.

of proposal cost or pricing data, the postaward audit is an invaluable tool to sharpen contracting, negotiating, and auditing expertise. It is felt by the General Counsel of DCAA that the greatest value of the postaward audit program is an improvement in contractor proposals and preaward audits due to the likelihood of later audits.[1]

As to the effectiveness of postaward auditing, it is believed that it is performing its function of saving money for the Government, although at present there is no record or measure of the actual dollar value saved. Even if a dollar-value saving were available there is no benchmark to be used as a comparison. The establishment of the postaward audit program is a worthy project, but to fulfill the task without an increase in auditing staff will detract from DCAA's primary task of preaward audits that assist contracting officers in the negotiation of fair and reasonable prices.

---

[1]Personal interview with Willard O. Vick, held at Cameron Station, Alexandria, Virginia, March 14, 1969.

CHAPTER V

GOVERNMENT ACCOUNTING OFFICE

Introduction

Chapter V will place the role of the Government Accounting Office in its proper perspective relative to the Truth in Negotiations Act, the Department of Defense, and the Congress. As an example of the results produced by GAO audits, recent GAO testimony before Congress and its effect upon the ASPR and the Act will be presented.

Purpose of GAO

The major objective of GAO is to assist the Congress of the United States in maintaining the surveillance necessary for effective legislative oversight of the complex of governmental programs and operations. Operating under the direction of Comptroller General Elmer B. Staats is the GAO staff of 4,300 people, of which 2,450 are professional accounting and audit staffers.[2] Approximately 1,100 of the professional staff are assigned to Defense operations with

---

[1]U.S., General Accounting Office, Annual Report, 1968 (Washington, D.C.: Government Printing Office, 1968), p. 9.

[2]Ibid., p. 6.

275 of these people performing Defense Procurement and Contracting audits.[1]

One of the basic roles of GAO is that of an independent auditor whose primary purpose is to examine the adequacy and effectiveness of the system of management and internal control, including internal governmental agency audits. The scope of this responsibility extends to activities conducted under contract as well as to those which the governmental agency itself conducts.

In order to perform its independent review functions as part of the legislative arm of the Government, GAO has been provided certain broad authorities by law for access to contractors' records.[2] The principal authority provided by these laws is the authority of the Comptroller General and his representatives to examine the records of contractors and subcontractors. This authority applies to the books, documents, and records that directly pertain to and involve transactions relating to Government contracts or subcontracts. This audit authority is effective for a three-year period commencing on the date of final contract payment.

---

[1]House, Subcommittee Hearings on Review of Defense Procurement Policies, Part I (1967), p. 10.

[2]Budget and Accounting Act, 1921 (31 U.S.C. 53); Budget and Accounting Procedures Act of 1950 (31 U.S.C. 67); Armed Services Procurement Act (10 U.S.C. 2313[b]); Federal Property and Administrative Services Act (41 U.S.C. 254[c]); Atomic Energy Act (42 U.S.C. 2206); Anti-Kickback Act (41 U.S.C. 53).

Keeping in mind that GAO auditing and early (1955) interest in Defense procurement and contracting procedures brought about the Truth in Negotiations Act, it is not surprising that GAO has professed a continuing interest in the subject. As late as 1967 GAO was advocating improved ASPR administrative procedures for the implementation of the Act.[1] In addition to administration of the existing Act, GAO recommended to Congress changes to the Act in order to improve the Government's position in negotiating and controlling procurement contracts.[2]

Reporting to Congress

In its capacity as an arm of Congress, GAO provides many services. Principal among them are:

1. Audit reports to Congress.
2. Special audit and investigative reports as requested by committees and individual Members of Congress.
3. Direct staff assistance to committees.
4. Comments to committees on pending legislation.
5. Advisory assistance in legal and legislative matters.
6. Testimony at hearings.
7. Recommendations for legislation.
8. Accounting and auditing advice on House and Senate financial and administrative operations.

During the period preceding the enactment of PL 87-653, as discussed in Chapter II, GAO performed all of the above services in order to show Congress the need for additional

---

[1]U.S., General Accounting Office, Need for Improving Administration of the Cost or Pricing Data Requirements of Public Law 87-653 in the Award of Prime Contracts and Subcontracts. Report to the Congress of the United States, B-39995, January 16, 1967.

[2]House, Subcommittee Hearings on Review of Defense Procurement Policies, Part I (1967), pp. 31-52.

contracting legislation. Reports to Congress, blue-book reports, commenced in 1957 to present the problems that surrounded Government operations. GAO also supplied testimony supporting Mr. Vinson's efforts to control incentive contracting. As enactment of a truth-in-negotiation type of law drew near, GAO supported the DOD premise that if a law was needed, then all negotiated contracting should be covered. In the final stages of the legislative procedure GAO lawyers assisted in the drafting of the actual legislation that became PL 87-653.

Testimony Before Congress

An example of GAO involvement with the continued implementation of the ASPR and PL 87-653 took place in 1967. In testimony before the House subcommittee for Special Investigations, Charles M. Bailey, Deputy Director of the Defense Division of GAO, stressed the following areas of the ASPR that had a need for improvement:

1. Need for improvement in contractor's submission of cost or pricing data in support of proposed prices. GAO audits have turned up a substantial number of cases where there has been no record of contractor submitted cost or pricing data, or, if submitted, it was incomplete. There have also been revealed instances where cost or pricing information that became available between the time the contractor submitted the proposal and the time of negotiation was not furnished to the Government.

2. Need for improvement in evaluation of contracting proposals by agency officials. Internal Government audits have disclosed inadequate technical evaluations of proposed costs based on the contractor's engineering documentation. GAO is also concerned about the apparent lack of supporting documentation, supervisory review, or criteria for evaluation of contractor proposals. There also appears to be a lack of depth and scope in the preaward audits as well as in the utilization of noncurrent price or cost experience data.

3. Need for improvement in actions by contracting officers for establishing reasonable negotiated prices. High contract prices were found by GAO auditors to be due in part to the failure of contracting officers to request preaward audits because of lack of time in an urgent procurement. There is also a failure to request postaward audits for the same reason. There has been a reluctance by contracting officers to utilize the advisory findings and recommendations that are available for proposed evaluation. GAO alleges that contracting officers are not requiring cost or pricing data in "questionable" cases by determining that "adequate price competition" or "catalog or market price" exceptions apply.[1]

Result of GAO testimony

The immediate result of this GAO testimony to Congress on the "need for improvement" and the earlier

---

[1] Ibid.

Report to Congress was the DOD issuance of two Defense Procurement Circulars.[1] In view of the GAO testimony, Congress commenced a study that ultimately resulted in the passage of an amendment to PL 87-653.[2]

DPC number 55 was issued on September 28, 1967, and promulgated a question-and-answer section as well as an example of a properly executed contractor submission of cost or pricing data (DD Form 633). DPC number 57 was issued on November 30, 1967, and revised the ASPR to include an access-to-records clause in firm-fixed-price and fixed-price-with-escalation types of negotiated contracts. The latter DPC resulted in the performance of postaward contract audits as advocated by GAO in all types of negotiated contracts, but only for the "purpose of determining whether or not defective cost or pricing data were submitted."[3] DOD commenced a training program which included the holding of seminars, by traveling experts, for contracting personnel and the publishing of a training course aimed at the correction of the problems specified in GAO's Congressional testimony.

GAO and DCAA Interface

Under its charter, DCAA is expected to maintain liaison with other components of the Department of Defense,

---

[1] GAO, Report to Congress, B-39995, February 1967; Department of Defense, Defense Procurement Circular Nos. 55 and 57.

[2] H.R. 10573.

[3] Defense Procurement Circular No. 57, p. 4.

other agencies of the executive branch, and GAO for the exchange of information and programs in the field of assigned responsibilities. Liaison with GAO for this purpose is carried on rather extensively at both headquarters and regional levels. DCAA receives copies of all GAO reports relating to contract matters and DCAA reviews proposed DOD responses thereto.[1]

In turn, GAO gives full consideration to the work of the audit organizations or the contracting agencies concerned. Moreover, the scope and effectiveness of the work of agency audit organizations on contract and agency activities are important considerations in determining the scope and nature of the audit work to be performed by GAO. By reviewing and testing the audit agency work, GAO often lessens the amount of its direct audit work. GAO field personnel are instructed that, in the review of contracts negotiated on the basis of reviews and evaluations performed by other agency representatives, they should evaluate such work. After its reliability has been tested, maximum use is made of the work of agency personnel, thus limiting the extent of further work that GAO needs to do. Because of this, the efforts of DCAA and GAO are considered complementary.

The institution of the DCAA controlled postaward auditing program is a GAO sponsored project that has the approval of Congress. The program relieves GAO of the task

---

[1]GAO, Report to Congress, B-39995, February, 1967, p. 52.

and is an indication of the growing Accounting influence in procurement matters.

Uniform Cost Accounting

In July, 1968, Senator Proxmire attached an amendment to the Defense Production Act extension which is of great import to the auditing activities of GAO and DCAA, and will bear heavily upon the defense contractors. GAO has been tasked by the amendment to study the feasibility of applying uniform cost accounting standards for use in all negotiated prime contract and subcontract defense procurements of $100,000 or more.

Why a uniform standard?

This amendment was prompted in part by Vice Admiral H. G. Rickover's testimony that:

> 1. the lack of uniform accounting standards is the most serious deficiency in Government procurement today;
> 2. industry will not establish such standards because it is not to their advantage to do so;
> 3. the accounting profession has had ample time and opportunity to establish effective standards but pays only lip service to the concept; and
> 4. if uniform accounting standards are ever to be established the initiative will have to come from Congress.[1]

Admiral Rickover went on to tie the need for uniform standards of accounting into the Truth in Negotiations Act by

---

[1] Testimony of Vice Admiral H. G. Rickover, USN, in U.S., Congress, House, Committee on Banking and Currency, To Renew the Defense Production Act of 1950, as Amended, Hearings, before the Committee on Banking and Currency, House of Representatives, 90th Cong., 2d Sess., April 10 and 11, 1968, pp. 77-83.

pointing out that "suppliers can inflate the costs they certify to be in accordance with the Truth in Negotiations Act, such that it is almost impossible to test what costs are included in the price, and what profit a contractor can realize on the order. For this reason cost breakdowns under the Truth in Negotiations Act do not preclude overpricing."[1]

How to implement the standard

The Comptroller General is approaching the Study task from the viewpoint that GAO will attempt to determine the feasibility of applying a uniform cost accounting standard as a means of enhancing the comparability, reliability, and consistency of cost data used for negotiated contract purposes.[2] Feasibility will be judged in terms of workability, administrative costs of implementation, and agreement among accountants of what constitutes "generally accepted accounting principles."[3]

---

[1] Ibid., p. 83.

[2] Elmer B. Staats, "Uniform Cost Accounting Standards in Negotiated Defense Contracts," The Federal Accountant, XVIII (March, 1969), 3-16.

[3] Ibid.

CHAPTER VI

CONCLUSION

It is the intent of Chapter VI to answer the research question, "Why is Public Law 87-653 so difficult to satisfy?" By drawing on the subsidiary questions and their conclusions, the reasons for the difficulties in satisfying PL 87-653 should become evident.

What prompted Congress to pass PL 87-653?

At the conclusion of the Korean Conflict, Congress became alarmed about the GAO reported continued increase in negotiated versus formally advertised procurements. By 1955, the General Accounting Office audit policy shifted emphasis from internal Government operations to the area of defense contracting. In 1957, GAO commenced issuance of its now famous blue-book reports, which reported to Congress a lack of competition in defense contracting and the excess profits generated by defense contractors.

Representative Carl Vinson, long an adversary of incentive contracting, began hearings and legislative submissions in an attempt to control incentive contracting. By 1962, it was inevitable that a law of some sort would be passed by Congress to control the GAO reported excess profits

and apparent deficiencies in Department of Defense procurement policies. The principals in the passage of PL 87-653--GAO, DOD, and Senator Russell--agreed that if a law were to be passed it should control all negotiated contracting and not incentive contracting alone, which all agreed would be a greater evil than no law at all.

It is apparent that the GAO generated concern of Congress about excess profits and DOD's inability to rectify the problem administratively resulted in the Truth in Negotiations Act. The haste exhibited in the rewriting of the final bill (four days) hints at the possibility that the Act is ill conceived from a legal standpoint and attempts to explain too much by a single principle--truth. Unanimous House and Senate passage of the Act does not reflect true acceptance of the Act. There is a long record of committee opposition as indicated by the four years it took from first introduction to passage. The unanimity of the floor votes only reflects the political truth that a vote against "truth" is akin to a vote against "motherhood."

Has PL 87-653 been fully implemented by Government and accepted by industry?

The discussion in Chapter III shows that since 1962, when the Truth in Negotiations Act was passed by Congress, there has been continuous administrative change in the regulations that implement the Act. The changes have been brought about by conflicting as well as complementary ASBCA

decisions, GAO efforts to bring the ASPR more in line with its interpretation of the original Act, two amendments to the Act itself as a result of GAO reports of industry non-compliance, and finally, the ASPR committee's efforts to make the ASPR more effective, uniform, and equitable in administering the Act.

The Act needs time to settle in order to be fully implemented, and time has not been given to it. It has been argued that as Government and industry gain experience in operating under the Act adjustments in implementation become necessary. Seven years of experience and change should be sufficient time to smooth out the administrative implementation of any law.

The trend of audits.--The General Accounting Office has long been an advocate of stronger controls on the profits and the costs of defense contractors. This interest has been documented from the early GAO shift in audit emphasis to the present blue-book reports and Congressional testimony that advocate stronger laws to implement PL 87-653 because of contractor excesses and DOD negligence. The result of GAO's efforts for stronger controls and implementation has taken the form of the Defense Contract Audit Agency. The DCAA has become a vital part of the implementation process of PL 87-653, and it is DCAA's role as postaward auditor that has created the current aura of hostility toward the Act.

Admittedly, auditing is the only way to ensure compliance with the law. It is industry's fear that postaward auditing will lead to the repricing of firm fixed-price contracts because of "excess" profits. In addition, postaward auditing has increased the amount of risk that industry must accept due to the three-year post-contract period that DCAA is now allowed for auditing.

There has been a greater emphasis on audit trails as a means of implementing the Truth in Negotiations Act, as evidenced by the sample pricing proposal in Defense Procurement Circular 55 and the addition of postaward audit and record maintenance clauses for fixed-price contracts in Defense Procurement Circular 57, to match the existing cost-type audit clause. These regulations are the direct result of GAO's leadership in and responsibility for interpretation of PL 87-653. All of these audit regulations are to assist in the implementation of a law which initially had no audit provision of its own.

As can be seen, the Government is becoming more and more interested in contractors' records and more deeply involved in the inner working of contractors' operations. Such records as minutes of the meetings of boards of directors and tax returns "if directly pertinent" and "involving transactions related to this contract" must now be made available to auditors.

Presently, GAO has been tasked with a feasibility study for Congress to determine if "uniform cost accounting standards" can be instituted in the defense industry. All indications, from past experience, are that auditing of contractor records will continue to intensify, as will the depth of the audits, in order to force implementation and conformance with the Act. The audits can be used to verify cost and profit figures in addition to the verification of contractor submitted cost or pricing data.

Government and industry spokesmen.--One of the admitted advantages of the Act is its broad principles, which leave its administration to procurement regulations.[1] Mr. Staats believes that as we gain experience there will be more changes to ASPR, although there have already been many regulation changes in this relatively new law.[2]

Industry has no quarrel with the objective of the Act--truth in negotiations. It is the practical implementation that causes the problem. The basic attribute of PL 87-653 that impedes industry compliance arises from the real or imagined uncertainty and one-sidedness of the Act. This one-sidedness can be illustrated by the following examples set forth by the Senior Vice President of the Machinery and Allied Products Institute, Mr. Derr:

1. the contractor--alone and without guidance--must decide what cost or pricing data may affect price

---

[1]Staats, "Truth in Negotiations Act in Perspective," p. 12.

[2]Ibid.

> as well as what cost or pricing data an auditor years hence may think did, or could have affected price;
>
> 2. he has the affirmative obligation of submitting and/or identifying all such data with the risk of an inadvertent transgression varying directly with the complexity of the negotiation and the volume of the data;
>
> 3. if challenged by the government under the general obligation, he must sustain the burden of showing that the inaccuracy, incompleteness, or non-currency of data alleged by the government did not result in a price increase;
>
> 4. if an audit of relevant data discloses a mixture of offsetting "overs" and "unders" affecting price he must give to the government the benefit of all "overs" with only a slim chance of claiming an offset for "unders."
>
> 5. a price reduction attributable to allegedly inaccurate, incomplete, or noncurrent data is a wholly unilateral action by government from which the contractor may, if he wishes, appeal to the Armed Services Board of Contract Appeals.[1]

Mr. Derr, whose organization is a leading spokesman for the industry viewpoint, believes "that the Truth in Negotiation law is bad law, poor economics and unsound procurement policy" and "that it was never needed and should never have been enacted."[2]

It is doubtful that PL 87-653 will ever be accepted as a friend of business. Industry objection has not altered the Act's implementation, and Congress is not disposed to repeal it. All that can be said is that industry is resigned to the fact that the Act is here to stay. Efforts to influence its implementation by logical discussions with GAO and DOD as well as court tests of various aspects of the Act appear to be the future course for industry.

---

[1] Derr, "An Industry View," p. 17.

[2] Ibid., p. 25.

The Comptroller General, Mr. Staats, realizes that present implementation is far from perfect when he admits that there will be more revisions to the implementing regulations in the future as we gain experience under the law. After seven years of effort to implement the Act, Mr. Staats says, "Perhaps sometime in the future we will even have substantial agreement between Government and industry that the Act is working fairly for both sides."[1]

The question of full implementation will probably never be answered because of its nebulous quality. What is full implementation? Is it perfect documentation with an accurate audit trail? Is it the lowest price to the Government with a fair profit to the contractor? Full implementation is both of these things, but the cost in time and dollars to achieve perfect documentation, and an accurate audit trail can far outweigh the advantage to be gained from obtaining the lowest possible price. Additionally, no one has been able to determine what a fair profit is; there are as many ways to compute profit as there are profit-making firms.

At this point in time, full implementation has not been reached, and it is unlikely that it will ever be known if or when it is reached.

---

[1]Staats, "Truth in Negotiations Act in Perspective," p. 13.

Conclusion

No one denies that truth in government negotiations is a worthy goal; the problem is how to obtain the "truth" while maintaining the competitive atmosphere and without excessive administrative burdens or costs being placed on Government or industry. The Government procurement situation is unique and therefore requires unique solutions to its problems. Without knowledgeable administrators in all phases of procurement and contracting, on both sides of the negotiation table, the ultimate result will never be achieved. The ultimate result is the delivery of the right item to the right place at the right time and at the right price.

If the ultimate result is not firmly kept as the primary purpose of the Procurement and Contracting endeavor, such extraneous efforts as perfect documentation and audit trails will become an end instead of being the means to an end. Also, it must be remembered that the leveling of new requirements upon the procurement function, whether it be Government or industry, does add to the cost of the item being procured.

"Public Law 87-653 is so difficult to satisfy" because of the hasty action of Congress in passing the law and the fact that the law has not been fully implemented by the government or accepted by industry. It is the firm belief of this writer that PL 87-653 can never be completely satisfied and that a patchwork approach to improved implementation

will only aggravate the implementation. Unless the law is understood it cannot be fully implemented, and if it is not implemented it cannot satisfy the intentions of Congress in passing the Act, i.e., to bring truth to the negotiating table. The goal of PL 87-653 is an admirable one, and the need for the exchange of pertinent information at the time of negotiations does exist, but this Act will not attain that goal without the expenditure of time and money that far exceeds the value returned.

APPENDIX A

SECTION (e) OF THE TRUTH IN NEGOTIATIONS ACT

THE TRUTH IN NEGOTIATION ACT

SECTION (e) OF PUBLIC LAW 87-653

(10 USC 2306(f))

A prime contractor or any subcontractor shall be required to submit cost or pricing data under the circumstances listed below, and shall be required to certify that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete and current--

(1) Prior to the award of any negotiated prime contract under this title where the price is expected to exceed $100,000;

(2) Prior to the pricing of any contract change or modification for which the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the head of the agency;

(3) Prior to the award of a subcontract at any tier, where the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, if the price of such subcontract is expected to exceed $100,000; or

(4) Prior to the pricing of any contract change or modification to a subcontract covered by (3) above, for which the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the head of the agency.

Any prime contract or change or modification thereto under which such certificate is required shall contain a provision that the price to the Government, including profit or fee, shall be adjusted to exclude any significant sums by which it may be determined by the head of the agency that such price was increased because the contractor or any subcontractor required to furnish such a certificate, furnished cost or pricing data which, as of a date agreed upon between the parties (which date shall be as close to the date of agreement on the negotiated price as is practicable), was inaccurate, incomplete, or noncurrent: Provided, That the requirements of this subsection need not be applied to contracts or subcontracts where the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, prices set by law or regulation or, in exceptional cases where the head of the agency determines that the requirements of this subsection may be waived and states in writing his reasons for such determination.

APPENDIX B

AMENDMENT TO SECTION (e) OF THE TRUTH IN NEGOTIATIONS ACT

AMENDMENT TO THE TRUTH IN NEGOTIATIONS ACT

SECTION (e) OF PUBLIC LAW 87-653

(10 USC 2306 [f])

For the purpose of evaluating the accuracy, completeness, and currency of cost or pricing data required to be submitted by this subsection, any authorized representative of the head of the agency who is an employee of the United States Government shall have the right, until the expiration of three years after final payment under the contract or subcontract, to examine all books, records, documents, and other data of the contractor or subcontractor related to the negotiation, pricing, or performance of the contract or subcontract.

Enacted September 25, 1968

APPENDIX C

ARMED SERVICES PROCUREMENT REGULATIONS

3-807.3 THROUGH 3-807.5

(2) Appropriate consideration should be given to Section XV, which contains general cost principles and procedures for the determination and allowance of costs in connection with the negotiation of cost-reimbursement type contracts, as well as guidelines for use, where appropriate, in the evaluation of costs in connection with negotiated fixed-price type contracts.

(3) Among the evaluations that should be made where the necessary data are available, are comparisons of a contractor's or offeror's current estimated costs with:

(i) actual costs previously incurred by the contractor or offeror;

(ii) his last prior cost estimate for the same or similar item or a series of prior estimates;

(iii) current cost estimates from other possible sources; and

(iv) prior estimates or historical costs of other contractors manufacturing the same or similar items.

(4) Forecasting future trends in costs from historical cost experience is of primary importance. In periods of either rising or declining costs, an adequate cost analysis must include some evaluation of the trends. In cases involving production of recently developed, complex equipment, even in periods of relative price stability, trend analysis of basic labor and materials costs should be undertaken.

3-807.3 *Cost or Pricing Data.* DPC #57

(a) The contracting officer shall require the contractor to submit in writing cost or pricing data and to certify, by use of the certificate set forth in 3-807.4, that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete, and current prior to:

(i) the award of any cost-reimbursement type, time and material, labor-hour, incentive, or price redeterminable contract regardless of dollar amount; except that certification of the data shall not be required in connection with cost and cost-sharing contracts, the estimated cost of which does not exceed $100,000, and under which the contractor receives no fee;

(ii) the award of any firm fixed-price or fixed-price with escalation negotiated contract expected to exceed $100,000 in amount;

(iii) any contract modification expected to exceed $100,000 in amount to any formally advertised or negotiated contract whether or not cost or pricing data was required in connection with the initial pricing of the contract;

(iv) the award of any negotiated contract not expected to exceed $100,000 in amount or any contract modification not expected to exceed $100,000 in amount to any formally advertised or negotiated contract whether or not cost or pricing data was required in connection with the initial pricing of the contract, provided the contracting officer considers that the circumstances warrant such action in accordance with (d) below;

unless, in the case of (ii), (iii) or (iv), the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. The requirements under (i), (ii), and (iii) above, may be waived in exceptional cases where the Secretary (or, in the case of a contract with a foreign government or agency thereof, the Head of a Procuring Activity) authorizes such waiver and states in writing his reasons for such determination. Whenever a Certificate of Current Cost or Pricing Data is required, the applicable clause in 7-104.29 shall be included in the contract, and the appropriate clauses in 7-104.41 and 7-104.42 shall be used if required in accordance with those paragraphs.

(b) Any contractor who has been required to submit and certify cost or pricing data in accordance with (a) above shall also be required to obtain cost or pricing data from his subcontractors under the circumstances set forth in the appropriate clause in 7-104.42.

(c) When there is adequate price competition, cost or pricing data shall not be requested regardless of the dollar amount involved. As a general rule, cost or pricing data should not be requested when it has been determined that proposed prices are, or are based on, established catalog or market prices of commercial items sold in substantial quantities to the general public. Where, however, despite the willingness of a number of commercial purchasers to buy an item at such a catalog or market price, the purchaser (*e.g.*, the contracting officer) finds that that price is not reasonable and supports such finding by an enumeration of the facts upon which it is based, cost or pricing data may be requested if necessary to establish a reasonable price; *provided*, that such finding is approved at a level above the contracting officer. In addition, cost or pricing data may be requested, if necessary, where there is such a disparity between the quantity being procured and the quantity for which there is such a catalog or market price that pricing cannot reasonably be accomplished by comparing the two. Where an item is substantially similar to a commercial item for which there is an established catalog or market price at which substantial quantities are sold to the general public, but the offered price of the former is *not* considered to be "based on" the price of the latter in accordance with 3-807.1(b)(2), any requirement for cost or pricing data should be limited to that pertaining to the differences between the items if this limitation is consistent with assuring reasonableness of pricing result.

[The next page is 358.3]

(d) The provisions of this subparagraph (d) do not apply to awards covered by (a) (i) above. Cost or pricing data shall not be requested prior to the award of any contract anticipated to be for $2,500 or less and generally should not be requested for modifications in those amounts. In procurements where it is anticipated that the contract award or modification will be between $2,500 and $10,000, cost or pricing data generally should not be requested. In almost all awards between $2,500 and $10,000 and modifications of $10,000 or less, the administrative costs will outweigh the pricing benefits which might otherwise accrue and some form of price analysis is almost always adequate in these situations. With respect to procurements where the amount of the award or modification is anticipated to be between $10,000 and $100,000, cost analysis and the obtaining of cost or pricing data from contractors shall be limited to cases where no satisfactory method of price analysis can be found.

(e) "Cost or pricing data" as used in this Part refers to that portion of the contractor's submission which is factual. The requirement for "cost or pricing data" subject to certification is satisfied when all facts reasonably available to the contractor up to the time of agreement on price and which might reasonably be expected to affect the price negotiations are accurately disclosed to the contracting officer or his representative. The definition of cost or pricing data embraces more than historical accounting data; it also includes, where applicable, such factors as vendor quotations, nonrecurring costs, changes in production methods and production or procurement volume, unit cost trends such as those associated with labor efficiency, and make-or-buy decisions or any other management decisions which could reasonably be expected to have a significant bearing on costs under the proposed contract. In short, cost or pricing data consist of all facts which can reasonably be expected to contribute to sound estimates of future costs as well as to the validity of costs already incurred. Cost or pricing data, being factual, is that type of information which can be verified. Because the contractor's certificate pertains to "cost or pricing data," it does not make representations as to the accuracy of the contractor's judgment as to the estimated portion of future costs or projections. It does, however, apply to the data upon which the contractor's judgment is based. This distinction between fact and judgment should be clearly understood.

DPC #57

PROCUREMENT BY NEGOTIATION

3-807.4 *Certificate of Current Cost or Pricing Data.* When a certification of cost or pricing data is required in accordance with 3-807.3, a certificate in the form set forth below shall be included in the contract file along with the memorandum of the negotiation. The contractor shall be required to submit the certificate as soon as practicable after agreement is reached on the contract price.

CERTIFICATE OF CURRENT COST OR PRICING DATA (OCT. 1964)

This is to certify that, to the best of my knowledge and belief, cost or pricing data* submitted to the Contracting Officer or his representative in support of _____** are accurate, complete and current as of the date of execution of this certificate.

Firm _____
Name _____
Title _____

_____***
Date of Execution

* For definition of "cost or pricing data", see ASPR 3-807.3(e).

** Describe the proposal, quotation, request for price adjustments, or other submission involved, giving appropriate identifying number (e.g., RFP No. _____).

*** As a general rule, this date should be the date when the contract price was agreed to. It is not intended that personal knowledge of the contractor's negotiator limits the responsibility of the contractor if the contractor had available at the time of the agreement information showing that the negotiated price is not based on accurate, complete, and current data. Contractors are expected to make a reasonable check to ascertain whether the concern had any information not personally known to the contractor's negotiator at the time of the agreement and which in accordance with ASPR 3-807.3 should be disclosed to the contracting officer for his consideration. Contractors are not expected to make a complete recheck of all data or develop a new cost estimate after the date of agreement and prior to execution of the contract. However, execution of a Certificate of Current Cost or Pricing Data is not intended to relieve a contractor of the responsibility for disclosing circumstances or events, happening subsequent to the date of certification but known to the contractor prior to the date of contract execution, which could reasonably be expected to have a significant bearing on costs under the proposed contract.

[The next page is 359]

3-807.5 *Defective Cost or Pricing Data.* DPC #57

(a) Where any price to the Government, including profit or fee and including price adjustments, must be negotiated largely on the basis of cost or pricing data furnished by the contractor, it is essential that all data that might reasonably affect the price negotiations be disclosed and that such data be accurate, complete, and current (see 3-807.3 and 3-807.4). If an agreed price includes amounts which can only be attributed to erroneous or incomplete cost or pricing data, it is not a fair price and the resultant profits are not earned profits. Where negotiations are to be conducted on the basis of full disclosure, failure of one party to proceed on that basis undercuts full mutual assent to the price negotiated so that, in this sense, the price is not fully agreed to, and fairness warrants its adjustment. The clauses set forth in 7-104.29 are designed to give the Government in such a case an enforceable contract right to a price adjustment, that is, to a reduction in the price to what it demonstrably would have been if the contractor had not failed to disclose significant and reasonably available data or had not furnished defective data.

(b) Under 10 U.S.C. 2306(f) and the "Price Reduction for Defective Cost or Pricing Data" clauses set forth in 7-104.29, the Government's right to reduce the prime contract price extends to cases where the prime contract price was increased by any significant sums because a subcontractor furnished defective cost or pricing data in connection with a subcontract where a certificate of cost or pricing data was or should have been furnished. These clauses also provide that the prime contractor and higher tier subcontractors shall include similar clauses in certain of their subcontracts to provide them with comparable rights to price reductions. In order to secure price reductions based on defective cost or pricing data furnished by a subcontractor, however, the Government, the prime contractor or higher tier subcontractor must be able to show that cost or pricing data furnished by subcontractors was, in fact defective. In some cases, as where the defective nature of a subcontractor's data is only disclosed by Government audit, the information necessary to support a reduction in prime contract and subcontractor prices may be available only from the Government. To the extent necessary to secure a prime contract price reduction, the contracting officer should make such necessary information available upon request, to the prime contractor or higher tier subcontractors; however, if the release of such information would compromise military security or disclose trade secrets or other confidential business information, it shall be made available only under conditions that will fully protect it from improper disclosure, as may be prescribed by: the Director of Procurement, the Office of the Assistant Secretary of the Army (Installations and Logistics), for the Army; the Office of Naval Material, for the Navy; the Office of the Assistant Secretary of the Air Force; and the Executive Director, Procurement and Production, for the Defense Supply Agency. Information made available pursuant to this paragraph shall be limited to that used as the basis for the prime contract price reduction.

(c) Inasmuch as price reductions under the Price Reduction for Defective Cost or Pricing Data clauses may involve first- and lower-tier subcontractors as well as the prime contractor, the contracting officer should give the prime contractor reasonable advance notice before making a determination to reduce the contract price under such clauses, in order to afford the prime contractor an opportunity to take any action deemed advisable by him, particularly in connection with any subcontracts that may be involved.

3-807.6 *Refusal To Provide Cost or Pricing Data.* If cost or pricing data from the contractor is required to permit adequate analysis of the contractor's proposal in accordance with 3-807.3 and the contractor has refused to provide such data, the contracting officer shall use those means available to him to attempt to secure such data. If the contractor persists in his refusal to provide necessary data, the contracting officer shall withhold making the award or price adjustment. In such event, he shall refer the procurement action to higher echelons of the Department. Such referral shall include a complete statement of the attempts made to resolve the matter, including (i) steps taken to secure essential cost data, (ii) efforts to secure the contractor's cooperation in the establishment of a satisfactory business relationship, (iii) any assurances offered, such as agreements to adequately safeguard information furnished, and (iv) a statement concerning the practicability of obtaining the supplies or services from another source of supply.

3-807.7 *Unacceptable Substitutes for Pricing Negotiations.* A Certificate of Current Cost or Pricing Data (see 3-807.4) shall not be considered a substitute for examination and analysis of the contractor's proposal. Contracting officers shall not rely on profit limiting statutes as remedies for ineffective pricing.

3-807.8 *Evaluation and Pricing of Individual Contracts.* Each contract shall be priced separately and independently, and no consideration shall be given to losses or profits realized or anticipated in the performance of other contracts. This prohibition neither prevents the negotiation of fixed overhead and other rates applicable to several contracts during annual or other specific periods nor prohibits forward pricing agreements applicable to several contracts. A proposed price reduction under another contract or other contracts shall not be used as an evaluation factor.

3-807.9 *Specified Contingencies.* When a contract is to include a provision for adjustment of price upon the happening of a specified contingency (e.g., escalation clauses, Government-furnished property clauses, tax clauses), the contract price should not include any amount on account of such contingency.

3-807.10 *Subcontracting Considerations in Cost Analysis.*

(a) The amount and quality of subcontracting may be a major factor influencing price. Since a large proportion of the procurement dollar is spent by prime contractors in subcontracting for work, raw materials, parts, and components, efficient purchasing practices by a contractor will contribute heavily toward efficient and economic production. While basic responsibility rests with the prime contractor for decisions to make or buy, for selection of subcontractors, and for subcontract prices and subcontract performance, the

[The next page is 360.1]

BIBLIOGRAPHY

Public Documents

U.S. Congress. House. Committee on Armed Services. Amendments to the Armed Services Procurement Act of 1947, Chapter 137, Title 10, United States Code. Report No. 1638 (To Accompany H.R. 5532), House of Representatives, 87th Cong., 2d sess., 1962.

_____. Amendments to the Armed Services Procurement Act of 1947. Report No. 1638, Pt. 2 (Minority Report) to Accompany H.R. 5532, 87th Cong., 2d sess., 1962.

_____. Pursuant to Section 4, Public Law 86-89, Hearings before a Special Subcommittee on Procurement Practices of the Department of Defense, House of Representatives. Appendix 4, Considerations of H.R. 12299, 86th Cong. 2d sess., 1960.

_____. Review of Defense Procurement Policies, Procedures and Practices, Part I--Introduction and Truth-in-Negotiation (P.L. 87-653). Hearings before the Subcommittee for Special Investigations, 90th Cong., 1st sess., August 3 and September 25, 1967.

_____. Review of Defense Procurement Policies and Practices, Part I--Truth in Negotiations. Report of the Subcommittee for Special Investigations, 90th Cong., 2d sess., February 29, 1968.

_____. Truth in Negotiations (H.R. 10573). Hearings before a Subcommittee for Special Investigations, House of Representatives, 90th Cong., 2d sess., 1968.

_____. Weapons System Management. Hearings before a Subcommittee for Special Investigations, House of Representatives, on H.R. 5532, 87th Cong., 1st sess., 1961.

U.S. Congress. House. Committee on Banking and Currency. Defense Production Act Extension. Report together with Additional Views (To Accompany H.R. 17268), House of Representatives, 90th Cong., 2d sess., 1968.

_____. To Renew the Defense Production Act of 1950, as Amended. Hearings before the Committee on Banking and Currency, House of Representatives, on H.R. 15683, 90th Cong., 2d Sess., April 10 and 11, 1968.

U.S. Congress. House. Committee on Government Operations. Defense Contract Audits (Reorganization of the Defense Accounting and Auditing Division of the General Accounting Office. House Rept. 1796, House of Representatives, 35th Report, 89th Cong., 2d sess., 1966.

U.S. Congress. House. Passage of Amendment to Armed Service Procurement Act of 1947, H.R. 5532, Truth in Negotiations Act, 87th Cong., 2d sess., August 28, 1962. Congressional Record, CVIII, 17920.

_____. Representative Bates speaking for the Amendments to Armed Services Procurement Act of 1947, H.R. 12572, 86th Cong., 2d sess., June 24, 1960. Congressional Record, CVI, 14258.

_____. Representative Wilber D. Mills speaking for the Renegotiation Act extension, H.R. 7086, 86th Cong., May 26, 1959. Congressional Record, CV, 9137.

_____. Representative H. Allen Smith speaking against the Amendment to the Armed Services Procurement Act of 1947, H.R. 5532, 87th Cong., 2d sess., June 7, 1968. Congressional Record, CVIII, 9968.

_____. Representative Vinson speaking on the Amendment to the Armed Services Procurement Act of 1947, H.R. 5532, 86th Cong., 2d sess., June 24, 1960. Congressional Record, CVI, 14257.

U.S. Congress. Joint Economic Committee. Economics of Military Procurement. Hearings before a Subcommittee of the Joint Economic Committee, Congress of the United States, Part 2, 90th Cong., 2d sess., 1968.

_____. Economy in Government Procurement and Property Management. Report of the Subcommittee on Economy in Government, Congress of the United States, 90th Cong., 2d sess., 1968.

U.S. Congress. Senate. Committee on Armed Services. Amending the Truth in Negotiations Act. Report No. 1506 (To Accompany H.R. 10573), Senate, 90th Cong., 2d sess., 1968.

_____. Amendments to Armed Services Procurement Act of 1947. Hearings before Procurement Subcommittee, 86th Cong., 2d sess., 1960.

_____. Amendments to the Armed Services Procurement Act of 1947. Hearings on H.R. 5532, 87th Cong., 2d sess., 1962.

_____. Report on Procurement. S. Rept. 1900, 86th Cong., 2d sess., 1960.

U.S. Congress. Senate. Passage of Amendment to Armed Services Procurement Act of 1947, H.R. 5532, Truth in Negotiations Act, 87th Cong., 2d sess., August 23, 1962. Congressional Record, CVIII, 17351.

U.S. Department of Defense. Armed Services Procurement Regulations: The 1969 Edition. Washington, D.C. Government Printing Office, 1968.

_____. Defense Contract Audit Agency. Department of Defense Directive 5105.36. June 9, 1965.

_____. Defense Procurement Circular No. 55. Washington, D.C.: Government Printing Office, 1967.

_____. Defense Procurement Circular No. 57. Washington, D.C.: Government Printing Office, 1967.

_____. Office of Assistant Secretary of Defense (I&L). Training Seminar on "Certified Cost or Pricing Data and Public Law 87-653." 1967.

U.S. Department of the Navy. Headquarters Naval Material Command. Survey of Procurement Statistics (NAVMAT P-4200). June, 1968.

U.S. General Accounting Office. Annual Report 1968. Washington, D.C.: Government Printing Office, 1968.

_____. Compilation of General Accounting Office Findings and Recommendations for Improving Government Operations. Report to the Congress of the United States, B-138162. March 3, 1964.

_____. Need for Improving Administration of the Cost or Pricing Data Requirements of Public Law 87-653 in the Award of Prime Contracts and Subcontracts. Report to the Congress of the United States, B-39995. January 16, 1967.

_____. Need for Postaward Audits to Detect Lack of Disclosure of Significant Cost or Pricing Data Available Prior to Contract Negotiation and Award. Report to the Congress of the United States, B-158193. February 23, 1966.

_____. Review of Extent to Which Military Procurement Agencies and Prime Contractors Have Obtained Certifications as to the Accuracy and Completeness of Cost Data Used in Negotiation of Contract Prices. Report to the Congress of the United States, B-125050. October 4, 1960.

_____. Survey of Reviews by the Defense Contract Audit Agency of Contractors' Proposals Subject to Public Law 87-653. Report to the Congress of the United States, B-39995. February 15, 1967.

Armed Services Board of Contract Appeals Decisions

American Bosch Arma Corporation. ASBCA No. 10305. December 17, 1965.

Aerojet-General Corporation. ASBCA No. 12264. April 29, 1969.

Bell & Howell Company. ASBCA No. 11999. April 15, 1968.

Cutler-Hammer, Inc. ASBCA No. 10900. June 28, 1967.

Defense Electronics. ASBCA No. 11127. May 24, 1966.

FMC Corporation. ASBCA Nos. 10095 and 11113. March 31, 1966.

Honeywell, Inc. ASBCA Nos. 12168, 12169, and 12170. November 30, 1967.

Lockheed Aircraft Corporation. ASBCA No. 10453. May 18, 1967.

Sparton Corporation. ASBCA No. 11363. August 25, 1967.

Books

Commerce Clearing House, 1968 Government Contracts Guide Chicago: Commerce Clearing House, Inc., 1968.

Machinery and Allied Products Institute. The Truth in Negotiations Act ... A MAPI Symposium. Washington, D.C.: Machinery and Allied Products Institute and Council for Technological Advancement, 1969.

Articles

Cuneo, Gilbert A. "The Practical Impact of Public Law 87-653 (Truth in Negotiations Act) on Primes and Subcontractors." The Federal Accountant, XVIII (March, 1969), 99-109.

"DOD to Start Post-Award Audits," Aviation Week & Space Technology, LXXXVII (December 4, 1967), 26.

Kaufman, Richard F. "Pentagon Procurement Billion-Dollar Grab Bag." The Nation, March, 1969.

Keller, Robert F. "The Role of the General Accounting Office in the Enactment and Implementation of Public Law 87-653--The Truth in Negotiations Act." The Federal Accountant, XVIII (March, 1969), 87-88.

Roback, Herbert. "Truth in Negotiating: The Legislative Background of P.L. 87-653." Speech presented to American Bar Association, Honolulu, Hawaii, August 8, 1967, Public Contract Law Journal, I, No. 2 (July, 1968), 3-29.

Staats, Elmer B. "Uniform Cost Accounting Standards in Negotiated Defense Contracts." The Federal Accountant, XVIII (March, 1969), 3-16.

Vick, Willard O. "Role of Defense Contract Audit Agency under Public Law 87-653." Public Contract Law Journal, I, No. 2 (July, 1968), 61.

Proceedings

DOD-Wide Procurement Pricing Conference. Proceedings of Panel No. 7, Cost and Pricing Data. Hershey, Pa., 1967.

Speeches

Keller, Robert F., General Counsel, Government Accounting Office. "Role of the General Accounting Office in the Enactment and Implementation of Public Law 87-653--The Truth in Negotiations Act." Speech before the Eighth Annual Institute on Government Contracts. September 12, 1968.

Steger, Merritt H. "Some Aspects of PL 87-653--The Truth in Negotiations Act." Speech before Briefing Conference on Government Contracts, Federal Bar Association. Philadelphia, Pa., March 4, 1968.

Weitzel, Frank H., Assistant Comptroller General of the United States. Speech before the Briefing Conference on Government Contracts. Philadelphia, Pa., March 4, 1968.

Personal Interviews

Chemery, Frank P., Assistant Director, Defense Division, Procurement Group, General Accounting Office, Washington, D.C. Personal interview, February, 1969.

Vick, Willard O., General Counsel, Defense Contract Audit Agency, Alexandria, Va. Personal interviews, February and March, 1969.

Other Sources

Machinery and Allied Products Institute. "Government Contracts: Truth-in-Negotiations Law." Bulletin No. 4170. September 11, 1967.

_____. "Government Contracts: The Cost or Pricing Data Submission Program." Memorandum GC-17. July 27, 1966.

_____. "Government Contracts: Truth-in-Negotiations Law." Memorandum GC-22. July 24, 1967.

_____. "Government Contracts: Truth-in-Negotiations Law." Memorandum GC-23. November 3, 1967.

_____. "Government Contracts: Truth-in-Negotiations Law." Memorandum GC-24. December 7, 1967.

_____. "Subcontracts." Memorandum. January 17, 1968.

_____. "The 'Price Reduction for Defective Cost or Pricing Data' Clauses." Memorandum. January 17, 1968.

_____. "The Requirements for Disclosure or Submission of Certified Cost or Pricing Data." Memorandum. January 17, 1968.

Truth in Negotiations--Part I: Law, Exemptions and Government Obligation to Disclose. Briefing Papers, No. 68-3, The Government Contractor. Prepared by Walter F. Pettit. Federal Publications, Inc., June, 1968.

Truth in Negotiations--Part II: Submission of Cost and Pricing Data, Audit, Remedies, and Subcontractor Problems. Briefing Papers, No. 68-4, The Government Contractor. Prepared by Gilbert A. Cuneo, Robert L. Ackerly, and John Lane, Jr. Federal Publications, Inc., August, 1968.

U.S. Department of Defense. Defense Contract Audit Agency. Fact Sheet on Defense Contract Audit Agency. September, 1968.